

# **Annual Report 2019** of Aareal Bank AG

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# Management Report

## Fundamental Information about the Group

### Business model

Aareal Bank AG, headquartered in Wiesbaden, Germany, is the parent company of the Group. Its shares are admitted to trading on the regulated market (geregelter Markt) of the Frankfurt Stock Exchange, and are included in the mid-cap MDAX® index.

The strategic business segments of Aareal Bank Group are commercial property financing and services, software products and digital solutions for the property sector and related industries.

### Structured Property Financing

In the Structured Property Financing segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and the Asia/Pacific region. Aareal Bank finances commercial property investments, especially for office buildings, hotels, retail, logistics and residential properties, with a focus on existing buildings. By combining local market expertise with sector-specific know-how from the Group's head office, Aareal Bank can offer financing concepts that meet the special requirements of its national and international clients, as well as concluding structured portfolio and cross-border financings.

Aareal Bank manages its sales activities in the individual regions worldwide via a network of sales centres (hubs). In addition to the locally-based experts, the distribution centres for sector specialists covering hotels, retail and logistics properties, as well as those catering to the specific needs of investment fund clients, are located in Wiesbaden.

There are two regional hubs in Europe: one hub combines sales activities for the euro zone, with a focus on the Benelux countries, France, Germany, Italy and Spain. An additional hub focuses on sales activities outside the euro zone, with a focus on the UK and Central and Eastern Europe. Distribution in Northern Europe is managed from the head office in Wiesbaden. As before, the hubs have a network – comprising branches in London, Paris, Rome, Stockholm and Warsaw – at their disposal. Furthermore, the Dublin branch holds securities. Representative offices are located in Istanbul, Madrid, and Moscow.

Aareal Bank Group's activities on the North American market are carried out through the subsidiary Aareal Capital Corporation, operating from New York City. The Singapore subsidiary Aareal Bank Asia Limited conducts the sales activities in the Asia/Pacific region.

### Funding

Aareal Bank is an active issuer of Pfandbriefe, which account for a major share of its long-term funding. Moody's Aaa rating of the Pfandbriefe confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank uses a wide range of other refinancing tools, including senior preferred and senior non-preferred bonds, as well as other promissory notes and bonds. Depending on market conditions, the Bank places large-sized public issues or private placements. In the Consulting/Services segment the Bank also generates deposits from the housing industry, which represent a strategically important additional source of funding. Furthermore, it has recourse to institutional money market investor deposits.

### Consulting/Services

In the Consulting/Services segment, Aareal Bank Group offers its clients from the housing sector and related industries – such as the energy sector – a combination of specialised banking services, software products and digital solutions. With its subsidiary Aareon, Aareal Bank has its own internal consultancy and IT systems house for the property sector in Europe.

Present at 37 locations in Austria, Germany, Finland, France, the Netherlands, Norway, Sweden, and the UK, Aareon offers its customers consulting, software and services to optimise IT-supported

business processes in the digital age, generating a stable and long-term business volume based on the experience gained in the past years with the enterprise resource planning (ERP) systems it offers. In addition, Aareon develops a portfolio of digital solutions with its international research and development teams and in cooperation with PropTech enterprises, offering these solutions internationally. "Aareon Smart World", the digital ecosystem, connects these solutions, networking property companies with customers, staff and business partners, as well as connecting technical devices in apartments and buildings. Aareon benefits from a cross-border transfer of know-how, leveraging the respective country-specific focal areas of digitalisation to expand its range of products and services. Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud.

In its Housing Industry division, Aareal Bank offers its customers products and solutions for optimising digital payments, electronic banking and cash management processes. It markets its BK01 software as a procedure in the German housing property industry for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. In addition to the German property industry, the German energy sector forms a second major client group of the Bank's Housing Industry division for the services mentioned above. This enables the offer of further products, facilitating the cross-sector cooperation of client groups and realising synergies via end-to-end digital processes. In conjunction with payment transactions processed via Aareal Bank's systems, deposits are generated that contribute significantly to Aareal Bank Group's refinancing base.

Within the Consulting/Services segment, Aareon and the Bank's Housing Industry division work closely together. The majority of clients in the Bank's Housing Industry division are also clients of Aareon.

## Management system

Aareal Bank Group is managed using key financial performance indicators, taking the Group's risk-bearing capacity into account. Management takes place primarily at Group level, and is additionally differentiated by business segment. Group management is based on medium-term Group planning, prepared annually, which is geared towards the Group's long-term business strategy. An extensive (management) reporting system regularly provides the information required for management and monitoring purposes.

The following indicators implemented within the scope of business and return management are Aareal Bank Group's key financial indicators. They were revised at the turn of the year within the scope of the strategic development "Aareal Next Level":

### ◆ Group/consolidated

- » Net interest income (in accordance with IFRSs)
- » Net commission income (in accordance with IFRSs)
- » Loss allowance (in accordance with IFRSs)
- » Administrative expenses (in accordance with IFRSs)
- » Operating profit (in accordance with IFRSs)
- » Return on equity (RoE; before taxes)<sup>1</sup>
- » Consolidated net income allocated to ordinary shareholders of Aareal Bank<sup>2</sup> as of 1 January 2020

<sup>1</sup> RoE before taxes =  $\frac{\text{Operating profit} \text{./. consolidated net income attributable to non-controlling interests} \text{./. AT1 coupon}}{\text{Average equity (IFRS) excluding non-controlling interests, other reserves, AT1 bond, and dividends}}$

<sup>2</sup> The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis

- 
- » Earnings per ordinary share (EpS)<sup>1</sup>
  - » Common Equity Tier 1 ratio (CET1 ratio) – Basel IV (estimated) –
  - » Liquidity Coverage Ratio (LCR) until 31 December 2019
  - ◆ **Structured Property Financing segment**
    - » New business<sup>2</sup>
    - » Credit portfolio of Aareal Bank Group
  - ◆ **Consulting/Services segment until 31 December 2019**
    - » Aareon's contribution to consolidated operating profit (in accordance with IFRSs)
  - ◆ **Aareal Bank's Housing Industry division segment as of 1 January 2020**
    - » Average deposit volume from the housing industry
    - » Net commission income (in accordance with IFRSs)
  - ◆ **Aareon segment as of 1 January 2020**
    - » Sales revenue (in accordance with IFRSs)
    - » Adjusted EBITDA<sup>3</sup>

The preservation of capital and the ability to distribute dividends are additional financial performance indicators applicable to Aareal Bank AG.

The Group's existing risk management system is used to manage and monitor the various risk exposures of Aareal Bank Group entities, in a centralised manner. All management-relevant information is systematically collected and analysed, to develop suitable strategies for risk management and monitoring. We also employ forecasting models for balance sheet structure, liquidity and portfolio development for strategic business and revenue planning. In addition to business-related management tools, we also use various other instruments to optimise our organisation and workflows. These include comprehensive cost management, centralised management of project activities and Human Resources controlling, for example.

Structured Property Financing also deploys supplementary management tools and indicators. The property financing portfolio is actively managed throughout Aareal Bank Group, with the aim of optimising its risk diversification and profitability. To develop risk- and return-oriented strategies for our portfolio, we evaluate market and business data, using this as a basis to simulate potential lending strategies, and to identify a target portfolio, which is part of Group planning. This helps us to identify – and to respond to – market changes at an early stage. Active portfolio management makes it possible for us to optimally allocate equity to the most attractive products and regions from a risk/return perspective, within the scope of our strategy. By taking into consideration maximum allocations to individual countries, products and property types in the portfolio, we ensure a high level of diversification and avoid risk concentrations.

In the Consulting/Services segment, or in the Bank's new Housing Industry division and Aareon segments, respectively, managing the Group entities allocated to the segment is oriented upon specific indicators depending on the respective company's core business. In addition, we use specific management indicators typical for advisory and other services in the IT business. Deposits generated from the housing industry business and net commission income will become key financial indicators, and Aareon's contribution to consolidated operating profit will be replaced by adjusted EBITDA, a standard target figure commonly applied to software companies, supplemented by sales revenue.

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<sup>1</sup> EpS =  $\frac{\text{Operating profit} \text{./. income taxes} \text{./. consolidated net income attributable to non-controlling interests} \text{./. AT1 coupon (net)}}{\text{Number of ordinary shares}}$

<sup>2</sup> New business = newly-originated loans plus renewals

<sup>3</sup> "Earnings before interest, taxes, depreciation and amortisation" Excluding strategic investments and non-recurring effects

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## Report on the Economic Position

### Macro-economic environment

The year 2019 was defined by many uncertainties and changes on both an economic and geopolitical front. Besides the economic slowdown compared with previous years, especially in the industrial sector, there were also significant developments in the interest rate environment and in central bank policy. Conflicts or political uncertainties in several regions of the world at the same time impacted directly or indirectly on the environment. The protectionist measures in several countries were recognised as one of the key drivers of the uncertainty.

### Economy

The economy slowed down in the euro zone, and real gross domestic product grew by 1.2%; the growth was thus lower year-on-year (2018: 1.9%). This was especially attributable to a weak industrial sector, which impacted Germany and Italy in particular.

The UK's economy grew by 1.4% (2018: 1.3%). Exports were up 3.7% year-on-year, mainly due to the inventory build-up of many companies as a result of the EU exit. The latter was a burdening factor overall that affected most economic players. The UK officially left the European Union on 31 January 2020 after the EU Withdrawal Agreement Bill was passed on 20 December 2019. As of 1 February, a transitional period is in place until year-end 2020, during which the UK remains a part of the EU single market. To avoid a hard Brexit, it is imperative that a trading agreement is concluded by 31 December 2020, which does not contribute to moderate the uncertainty reigning since 2019.

In the US, real economic growth cooled off to 2.3% (2018: 2.9%), especially due to fewer investments. This level can be described as moderate for the US. Consumers continued to benefit from the good employment situation, which supported consumption. At 1.6%, growth in Canada was lower than in the previous year (2.0%). Lower export growth and less investments were the main reasons for this development.

As expected, economic growth in the Asia/Pacific region was lower than in the previous year. This was particularly evident in China, which recorded growth of 6.1% per annum compared with 6.7% p.a. in 2018. The decline was attributable to the trade conflict with the US as well as to the slowdown in credit growth. Growth in economic output amounted to 1.8% in Australia and was thus down on the previous year (2.7%), with lower consumer spending in the second half of the year a contributory factor.

The labour markets were positive in almost all regions in 2019. The unemployment rate in the euro zone fell by a total of 0.6 percentage points to 7.6%. Higher declines were recorded in Spain and Italy in particular. The unemployment rate in the US declined to 3.7% and to 5.2% in Australia. In contrast, the unemployment rate in the UK rose by 0.7 percentage points to 3.2%.

Inflationary pressure eased in the currency areas that are relevant for Aareal Bank Group, especially due to the economic slowdown. Inflation fell by 0.6 percentage points both in the euro zone and the US to 1.2% and 1.8%, respectively. It fell by as much as 0.7 percentage points in the UK to 1.8%.

**Annual rate of change in real gross domestic product**

	2019 <sup>1)</sup>	2018 <sup>2)</sup>
%		
<b>Europe</b>		
Euro zone	1.2	1.9
Belgium	1.4	1.5
Germany	0.6	1.5
Finland	1.5	1.7
France	1.3	1.7
Italy	0.2	0.7
Netherlands	1.7	2.5
Austria	1.5	2.3
Spain	2.0	2.4
Other European countries		
United Kingdom	1.4	1.3
Poland	4.2	5.1
Russia	1.3	2.3
Sweden	1.2	2.3
Switzerland	0.8	2.8
<b>North America</b>		
Canada	1.6	2.0
USA	2.3	2.9
<b>Asia/Pacific</b>		
Australia	1.8	2.7
China	6.1	6.7

<sup>1)</sup> Preliminary figures; <sup>2)</sup> Adjusted to final results

**Financial and capital markets, monetary policy and inflation**

The year 2019 on the capital markets was defined by falling long-term and short-term interest rates in nearly all currency areas. While a basic expectation for rate increases still prevailed last year, this changed following the adjustments made by key central banks to their monetary policy. The markets were open without limitation for new issues and refinancing, which was reflected in yields close to 0% and a 3.4% increase in gross sales of Mortgage Pfandbriefe in Germany up to the end of October.

During the year, the European Central Bank (ECB) announced the introduction of new long-term refinancing transactions (TLTRO) and its intention to leave the key interest rates at their current level until mid-2020 at least. However, it lowered the interest rate for the deposit facility by 10 basis points to -0.50%, additionally scaling the deposit rates depending on the deposit volume. It also re-launched an asset purchase programme of € 20 billion per month since November. Having raised its main re-financing rate (fed funds) in December 2018, the US Federal Reserve (Fed) turned its policy around and lowered it three times during 2019, by 25 basis points on each occasion. It also emphasised

the return to an expansionary monetary policy when it started buying US\$ 60 billion of treasury bills per month. The Bank of England made no changes to interest rates in light of the unclear situation surrounding Brexit. The Swedish Riksbank left its main interest rate unchanged in 2019 but decided in December to raise it by 0.25 percentage points to 0.0% from 8 January 2020.

The euro's performance vis-a-vis the currencies that are relevant for Aareal Bank was varied during the year. There was no uniform trend in the euro/US dollar exchange trade either. The US dollar had made gains up to October, only to lose these again over the remainder of the year. Nonetheless, its value at year-end was above that of the end of the previous year. Although the pound sterling at year-end was higher against the euro than at the start of the year, it shed around 9% in value between May and August as a result of the uncertainties surrounding the UK's withdrawal from the EU

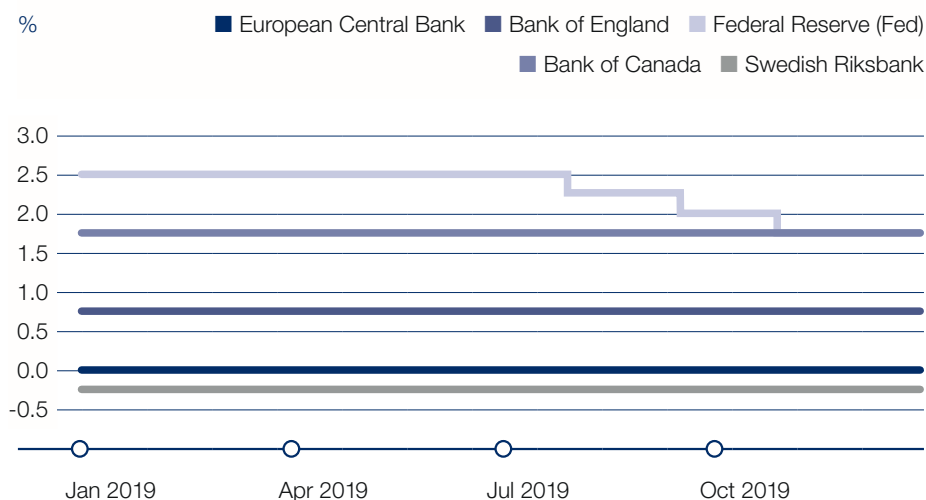
before climbing again in the last quarter of the year. The Swiss franc and the Canadian dollar both made gains over the euro, while the Swedish krona and the Australian dollar weakened.

Short-term interest rates<sup>1</sup> fell in most of the relevant currency areas. Measured in euros, they fell in the single-basis point range, thus reinforcing the negative interest rate environment. Measured in US dollar, they fell by around 90 basis points, by 40 basis points in Canadian dollar and by as much as approximately 120 basis points in Australian dollar. The pound sterling also declined, by 12 basis points in this case. Short-term interest rates denominated in Swedish krona bucked the trend to increase by around 20 basis points and were therefore above the zero per cent line, having fallen below it at the start of the year.

A continuous downward trend, whose magnitude was almost identical in all relevant currency areas, established itself for long-term interest rates<sup>2</sup> in the course of the year.

Yields on ten-year government bonds fell during 2019 in the countries that are relevant to Aareal Bank, falling below the zero per cent mark for Germany. However, the spreads of Italian and Spanish government bonds relative to long-term German issues tightened due to the more pronounced decline in yields in Italy and Spain.

### Key rate developments in 2019<sup>3)</sup>



<sup>3)</sup> The chart shows the upper level of the corridor for Fed Funds.

Notwithstanding political uncertainties, the primary market in the euro zone's covered bond segment was very strong in 2019 and defined by falling yields. Covered bonds totalling € 135 billion were issued last year, the highest volume since 2015, with German issuers accounting for the highest share of € 26.5 billion or 40 placements.

As in previous years, the ECB had stepped up its role as a buyer again since the end of year within the framework of its purchase programme, in response to the weak macro-economic developments in 2019.

Many investors hoped in vain again for a rise in interest rates in 2019. The ECB's expansionary monetary policy led to a significant decline in yields during the year.

The German Pfandbrief, which is considered formative for the European covered bond market, celebrated its 250th birthday in 2019.

<sup>1</sup> Calculated on the basis of 3-month Euribor or the corresponding LIBOR or other comparable rates for other currencies

<sup>2</sup> Calculated on the basis of swaps in the respective currencies



## Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, the implementation of the final draft of the Basel III framework into EU law (known as “Basel IV”), which was endorsed by the Basel Committee’s Group of Governors and Heads of Supervision (GHOS). Furthermore, the EU Commission’s revision of supervisory regimes (CRR II, CRD V, BRRD II and SRMR) at EU level as well as the EBA documents (Guidelines on PD and LGD estimation, treatment of defaulted exposures, and determination of downturn LGD), brought about further regulatory changes. The provision put forward by the ECB, EBA and the EU Commission on the treatment of non-performing loans must also be taken into account. Moreover, both national and European regulators are imposing various new requirements – including in connection with IT/information security risks, or regarding the prevention of money laundering, tax evasion and terrorist financing. Furthermore, politics and the banking supervision deem it necessary to establish sustainability more strongly with society, and as a regulatory requirement within the economy. As such, the EU’s Technical expert group on sustainable finance published the “Technical report on the EU taxonomy”, and BaFin issued its “Guidance Notice on Dealing with Sustainability Risks” at the end of 2019.

The ECB’s Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance, as well as of the capital and liquidity risks. The results of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity buffers.

Following an amendment to the German Regulation Determining Critical Infrastructure (Verordnung zur Bestimmung Kritischer Infrastrukturen – “BSI-KritisV”) in 2017, Aareal Bank is now additionally subject to reporting requirements vis-à-vis the German Federal IT Security Authority (BSI). The BSI required that areas and systems classified as ‘critical infrastructure’ had to be certified by mid-2019.

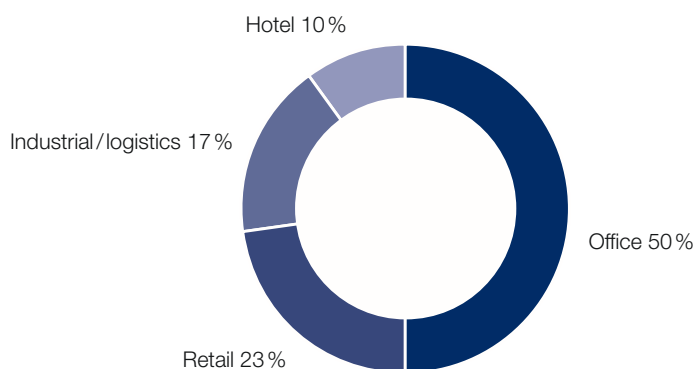
## Sector-specific and business developments

### Structured Property Financing segment

Transaction activity worldwide in commercial property was lower than in the previous year. However, differences were observed depending on the property type. While transaction volumes in retail property declined by around 30%, they increased for the other relevant property types between 4% and 10%. Reticence among investors in retail property was evident in light of the upheavals, through online trading among other things.

### Share of transaction volume observed worldwide in 2019

%



Office properties benefited from the long economic cycle and the positive sentiment that continues to prevail in the service sector. In most markets, yields<sup>1</sup> remained on a very low level in 2019 – in part significantly below 4%. They eased in Europe by around 25 basis points on average during the course of the year, while remaining stable in the US. They also remained stable in China and Australia. A low single-percentage increase on average was observed in rents offered in Europe, the US and Australia. They remained stable on the other hand in China.

In contrast, yields on retail property rose by a few basis points on average in Europe in 2019, while remaining stable in the Asia/Pacific region and the US. Low single-percentage declines in rents on average were observed in Europe. Rents remained stable in the Asia/Pacific region and in the US.

Yields on European logistics properties decreased by an average of 25 basis points, whilst rents offered in Europe fell by an average of 1.7% (2018: 2.5%).

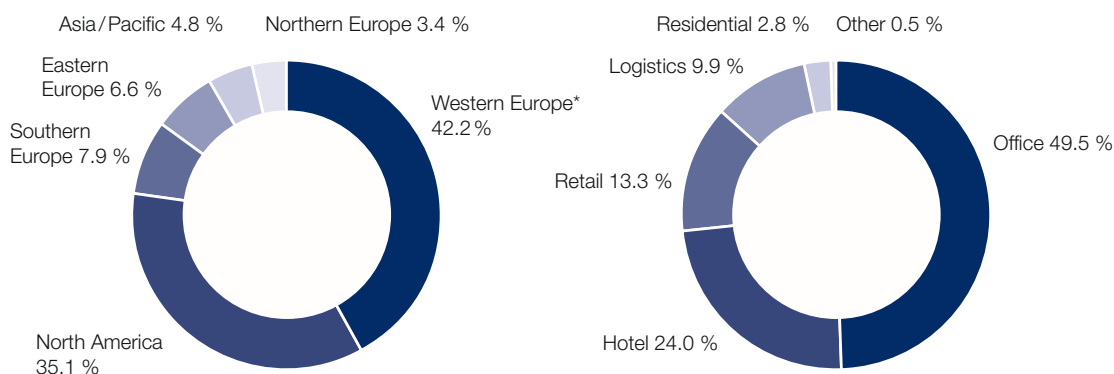
The willingness among market participants to provide finance varied during the year. In the Bank Lending Survey for the third quarter, the ECB reported on falling lending standards in Europe and lower margins due to heightened competition between the banks. However, this applied to all areas of the economy. The margin and competitive situation can also be applied to commercial property markets, as Aareal Bank observed pressure on margins in many European markets during the course of the year. In the UK, however, the willingness to provide financing for commercial property purchases fell. Lending in the US was up 13% year-on-year in 2019, with the volume of CMBS issued particularly increasing in November, albeit less than in the previous year from a full-year perspective. All in all, it can be said that competition remains intense, which is supported by the pressure on margins in numerous European markets. Margins remained under pressure in North America too, but remained higher than in the euro zone.

In a highly competitive environment defined by uncertainties, Aareal Bank Group generated new business volume totalling € 7.7 billion (2018: € 9.5 billion) in the year under review, this was in line with our planning.

The share of newly-originated loans relative to new business was 80.1% (2018: 75.8%) or € 6.2 billion (2018: € 7.2 billion). Renewals amounted to € 1.5 billion (2018: € 2.3 billion). At 60.1% (2018: 58.8%), Europe accounted for the largest share of Aareal Bank Group's new business, followed by North America with 35.1% (2018: 38.6%) and the Asia/Pacific region with 4.8% (2018: 2.6%). The higher share of financings in the Asia/Pacific region is due entirely to newly-originated loans.

## New business<sup>2)</sup> 2019

by region | by type of property (%)



\* Including Germany

<sup>2)</sup> New business, excluding private client business and local authority lending business of former WestImmo

<sup>1</sup> Falling yields are usually associated with rising property market values, all other things remaining equal.

With a share of 49.5% (2018: 26.7%), office property accounted for the largest share in new business in terms of property type, followed by hotel property, with 24.0% (2018: 35.3%), ahead of retail property with 13.3% (2018: 23.3%) and logistics property with 9.9% (2018: 7.8%). The share of residential property was 2.8% (2018: 5.5%), while other property and financings accounted for 0.5% (2018: 1.4%).

### Europe

Transaction volumes generated in Europe in 2019 were roughly 10% lower than in the previous year which was attributable in particular to lower transaction activities in retail and logistics properties, and to a decline of around 30% in the UK, which is one of the largest European markets. In the UK, the exit from the EU was one of the reasons for the subdued market; however, investor reticence for retail properties also negatively impacted transaction volumes. The volumes transacted in office and hotel property on the other hand was higher year-on-year. In Europe, cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

Rental growth in the market for office property in Europe was positive on average in 2019. This trend has persisted since early 2013. At the same time, yields fell by an average of 25 basis points (2018: -8 basis points).

The situation with retail property painted a different picture. Shopping centre rents, in particular, fell by 1.8% (2018: +2.2%) across the whole of Europe. The weighted yield rose by 26 basis points (2018: +3 basis points).

Logistics properties remained attractive for investors in 2019. Whilst rents dropped by 1.7% year-on-year (2018: +2.5%), this did not affect Aareal Bank's key markets. An average decline of 25 basis points (2018: -23 basis points) in weighted investment yields attested overall continued investor demand.

Hotel properties showed largely positive trends in Europe in 2019, thanks to the sustained economic boom, with occupancy rates rising by 0.4% year-on-year. A 1.8% increase in the average room rate led to a 2.2% growth in average revenue per available room, which was down on the previous year (2018: 5.2%). The increase in the number of rooms available was reflected here. The particularly positive performance in London should be highlighted. Despite uncertainties surrounding Brexit, the increase in average revenue per available room was twice that of the European average.

The Bank originated new business of € 4.6 billion (2018: € 5.6 billion) in Europe during the year under review. As in previous years, Western Europe again accounted for the largest share of € 3.2 billion (2018: € 3.5 billion) with the strongest countries being France and Germany. Southern Europe followed with € 0.6 billion (2018: € 1.2 billion), Eastern Europe with € 0.5 billion (2018: € 0.3 billion) and Northern Europe with € 0.3 billion (2018: € 0.6 billion).

### North America

The volume of transferred commercial property in the US in 2019 was roughly unchanged from the previous year's figure. Office property values were stable, while fewer retail and hotel properties – as measured by volume – were transferred than in the previous year. Transaction volumes in hotel properties in Canada were roughly 18% lower than in the previous year. Institutional and private investors were on the buy side for the most part, while cross-border investors and REIT structures tended to be sellers.

In the market for office property, rents offered in the US rose overall by just over 2%. The growth in rents in the metropolitan areas on the west coast tended higher than those on the east coast. On the other hand, yields hardly changed compared with the end of the previous year.

Rent offered for retail property in the US increased by 1.0%, although there were regional differences here in the amount as well as in the course of growth. Some locations such as Boston or Chicago featured falling quoted rents. The yields did not change compared with the end of the previous year.

On the hotel markets in the US, growth in average revenue per available room stagnated in the year under review, with average room rates going up by 1.0% and occupancy rates remaining at the previous year's level. Seeing as revenue per available room is at its highest since 2007, the discussed development is still positive. Average revenue per available hotel room was stable in Canada. Lower occupancy rates were offset by a higher average room rate.

Aareal Bank originated new business of € 2.7 billion in North America during the year under review (2018: € 3.7 billion). This business was concluded in the US and Canada.

### Asia/Pacific region

The volume of transferred commercial property in the Asia/Pacific region in 2019 was approx. 10% below the previous year's figure. The level in Australia, on the other hand, remained the same year-on-year. Cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

The situation on the market for office property was mixed in the Asia/Pacific region. While rents in Australia increased significantly by just over 5%, they fell in China by an average of 3.5%.

Developments on the market for retail property in the Asia/Pacific region were comparable. Rents and yields were largely stable.

Hotel property in the Asia/Pacific region experienced a 3.2% decline overall in revenue per available room, which was due to falling occupancy rates and lower average room rates. Regionally, the decline is attributable in particular to negative developments in Northeast Asia.

The Bank originated new business of € 0.4 billion in the Asia/Pacific region during the year under review (2018: € 0.2 billion), including financing of student housing complexes in Australia.

### Integration of former Düsseldorf Hypothekbank AG:

As planned, Aareal Bank Group concluded the integration of former Düsseldorf Hypothekbank AG (Düsseldorf Hypo) during the first half of 2019, with the split-off of former Düsseldorf's banking operations.

### Consulting/Services segment

#### Bank division Housing Industry

Business development in the German housing industry proved solid in 2019 as well. Rental income has increased overall as in the previous year. Together with the long-term financing structures and very low interest rates, they secure a solid foundation and facilitate entrepreneurial investments. Nationwide, rents were around 2.7% higher year-on-year (compared with an increase of 2.9% in 2018).

However, market development varied from region to region. While rents rose by 0.8% on average in rural areas in the third quarter of 2019, average rents in the municipal districts fell by 0.3%. They also stagnated in the most popular cities ("Schwarzstädte"), while continuing to rise in the surrounding areas; this suggests that tenants are migrating out of metropolitan areas.

There is still a housing shortage. At 257,000, the number of construction permits for apartments in 2019 is down by nearly 2% on the previous year's figure. A lack of available and affordable building land and of employees in the responsible licensing authorities is making it difficult to improve the situation; low capacity at the construction firms and high construction costs are holding back major investments. The federal government's coalition agreement estimated the average demand for new apartments at 375,000 per annum (from 2017 to 2021); this continues to be clearly missed.

The vacancy ratio based on the housing stock managed by GdW enterprises varies: at 1.4%, the ratio in the former West German Federal states is unchanged from the previous year and should rise to 8.5% (2018: 8.3%) in the former East German states.

The Housing Industry division further strengthened its market position in the 2019 financial year, bringing in more business partners from the institutional housing and commercial property industries – managing more than 235,000 residential units between them – for the payments and deposit-taking businesses. Moreover, it intensified existing business relationships. We also continuously succeeded to position ourselves as a partner in the energy and waste disposal industry, particularly within the scope of digitalisation, especially through interface products (such as BK01 eConnect and BK01 immoconnect) facilitating cross-sector collaboration amongst our client groups. Examples include accounting documentation and invoicing of energy supplies.

With plusForta AG, Aareal Bank has acquired one of the leading German providers of tenant deposit guarantees in 2019. The additional tenant deposit alternative will be gradually integrated in our technical systems and expands the range of property industry services in the area of deposit guarantees. The purchase of software from Deutsche Kautionspartner for managing rent deposits held with other banks will complete the range in addition to Aareal Bank's account maintenance service.

In addition, the Housing Industry division has analysed the development of alternative online payment systems very intensively and is integrating corresponding procedures into existing programmes

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and processes. The corresponding Aareal Exchange & Payment Platform product is currently in a pilot phase and is expected to be placed on the market in 2020.

At present, more than 3,500 business partners throughout Germany are using our process-optimising products and banking services. The high volume of deposits, averaging € 10.7 billion (2018: € 10.4 billion) in the year under review, is in line with the strategic orientation. The share of rent deposits and reserves in accordance with the German Residential Property Act was increased once again. Deposits averaged € 10.9 billion in the fourth quarter of 2019 (Q4 2018: € 10.4 billion) which we see as a sign of the trust our clients put in us.

### **Aareon**

Aareon is a consultancy and IT systems house for the property industry and its partners in Europe. It pursues a profitable growth strategy, and continued to grow in 2019. Key factors to its success are client orientation, the growth in digital solutions, further strengthening of the ERP systems and exploration of new relevant markets and related sectors associated with the property industry. In the course of Aareon's forward-looking orientation and further intensification of research and development, a strategic investment programme focusing on digital solutions was launched specifically for this purpose. The process of internal optimisation to enhance the organisational performance and profitability also continued, and the operative organisational structure with three cross-border divisions – sales, operating (including ERP and outsourcing) and digital business – was organised to enhance proximity to the market and clients.

Aareon's contribution to earnings in the 2019 financial year was € 37 million (2018: € 36 million), including strategic investments of € 3 million, thus corresponding to its earnings forecast. This was essentially due to recurring revenues and the consulting business in all product segments, as well as to the significant revenue growth of digital solutions which are reported under commission income.

Numerous additional clients, including key accounts, were acquired for the Wodis Sigma ERP solution in the DACH region (Germany, Austria and Switzerland). Among these new customers, there are still many previous GES clients, most of whom have opted in favour of one of the Wodis Sigma modern ERP systems or for SAP® solutions and Blue Eagle, or their systems were already migrated. As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. Aareon continued to implement a large number of migration projects. The total number of Wodis Sigma customers has therefore increased to around 1,050 as at year-end. The business volumes conducted with Wodis Sigma as well as with SAP® solutions and Blue Eagle increased year-on-year. The increased business volume and regular price adjustments led to higher revenues from maintenance and SaaS contracts. Consulting revenue increased as well. Additional commercial property clients were acquired for the RELion ERP solution, resulting in higher licence and consulting revenue. The mse subsidiaries were renamed as Aareon RELion in November. The positive trend in the outsourcing business continued unabated. BauSecura's insurance business has been running slightly above the previous year's level.

The marketing process for the Aareon Occupant Change Management solution continued to run on the utilities market.

In the Netherlands, several key accounts opted for long-term contracts with the Tobias ERP solution – some products were rolled out with key accounts, too. No losses of major clients were reported. The market launch of the new Tobias 365 ERP product generation started in the second quarter on the basis of Microsoft® Dynamics® 365. The distribution of the Dutch REMS ERP solution for the commercial property business was in line with the previous year. In France, several new clients were acquired in the course of the ELAN Law, which was passed in October 2018. Several new clients were acquired in the UK, including one important key account. ERP demand also concentrated on individual software adjustments and additional modules. Aareon Sverige was able to win key tenders with the Incit Xpand ERP solution, for example with several Swedish local authorities. The key tender with the housing company OBOS, managing around 220,000 units, was won in Norway. Following the successes on the Finnish market, Aareon Sverige founded the subsidiary Aareon Finland OY at the start of the year.

Digitalisation is becoming increasingly important for the property industry. With its Aareon Smart World digital ecosystem, Aareon offers integrated solutions for automating the business processes and networking business partners and market participants. The digital transformation process for customers is therefore focused on creating added value. Aareon continues to steadily expand this offer, and benefits from the transfer of international know-how in research and development, as well as from the exchange with the proptech and start-up scene. In the Netherlands, Aareon Nederland

acquired a minority stake in the Dutch PropTech OSRE B.V. ORSE designed a digital solutions platform that makes property sales and rental transactions more efficient. The first investment of subsidiary AV Management GmbH, which operates under the Ampolon Ventures brand, was ophigo which was presented at the MIPIM in Cannes and Expo Real in Munich. ophigo offers a digital platform for finding office space.

In November, Aareon signed the contract to acquire CalCon with effect from 1 January 2020. This acquisition supports Aareon's international growth strategy. The epiqr product for structural condition assessment and the new CalCon AIBATROS product generation will complement Aareon Smart World's product range.

The business volume generated with digital solutions has continued to grow strongly, by approximately 20% year-on-year, with a growing number of clients enhancing their ERP systems with the addition of integrated digital solutions, thus developing their own digital ecosystem. The Aareon Smart Platform was introduced in Germany, France and the Netherlands, with five customers in France already opting for this offer. The Aareon Smart Platform is an open platform that allows clients and partners to develop own solutions and integrate them securely into Aareon Smart World.

## Financial Position and Financial Performance

### Financial performance

Aareal Bank AG closed the 2019 financial year – which was characterised by a demanding and challenging market environment, as in the previous year – with an operating profit (excluding loan loss provisions) of € 180.7 million (2018: € 256.7 million).

The aggregate of net interest income and net commission income amounted to € 482.6 million, down € 65.7 million compared to the previous year. Interest income from lending and money-market transactions rose by € 29.0 million year-on-year, whilst interest income from securities declined by € 27.3 million. Interest expenses were up by € 42.1 million. Current income of € 63.0 million during the year under review (2018: € 100.8 million) was attributable to interests in affiliated companies. Net commission income of € 13.4 million was up € 12.5 million year-on-year.

Administrative expenses (including depreciation and amortisation of intangible assets and tangible fixed assets) of € 301.7 million were € 6.5 million lower than in the previous year, especially due to the decrease in non-personnel administrative expenses.

Net other operating income and expenses showed a decline of € 16.8 million year-on-year, to € 0.2 million. The income from the reversal of provisions included in this item markedly declined.

The balance of provisions for loan losses and the result from securities held as liquidity reserve amounts to € -198.4 million (2018: € -124.3 million). This figure includes expenditure for specific and general loan loss provisions, as well as allocations to general risk provisions in accordance with section 340f of the HGB. Securities held as liquidity reserve were revalued strictly at the lower of cost or market; the item also includes capital gains and losses realised on this portfolio.

The acquisition of the split-off banking operations of the former Düsseldorf resulted in an extraordinary income from the disclosure of hidden reserves in the acquired net assets in the amount of € 37.3 million.

Net other income and expenses of € 91.7 million (2018: € 30.3 million) includes the transferred results and revaluation of subsidiaries as well as the results from securities held as fixed assets and non-income taxes.

Taking into account a net income tax claim of € 8.4 million (2018: net income tax liability of € 37.0 million), the Bank posted net retained profit (Bilanzgewinn) of € 119.7 million (2018: € 125.7 million), which permitted Aareal Bank AG to achieve its targets of preserving capital, and its ability to distribute dividends. Likewise, the Bank largely fulfilled – or exceeded – its targets with regard to the following key financial indicators at Group level, in accordance with IFRSs, with net interest income of € 533 million, € 90 million in loss allowance, net commission income of € 229 million and administrative expenses of € 488 million. Overall, Aareal Bank generated operating profit of € 248 million, earnings per ordinary share of € 2.42, and RoE before taxes of 8.7%.

## Financial position

Aareal Bank AG's total assets as at 31 December 2019 amounted to € 38.9 billion, after € 38.6 billion as at 31 December 2018. The increase in total assets was due, inter alia, to higher term deposits.

Net assets are dominated by the property financing business and securities investments.

The book value of debt and other fixed-income securities amounted to € 6.9 billion as at 31 December 2019 (31 December 2018: € 6.9 billion). They comprise three asset classes: public-sector borrowers, covered bonds and Pfandbriefe, as well as bank bonds.

### Structure of the property financing portfolio

The volume of Aareal Bank AG's property financing portfolio stood at € 22.8 billion as at 31 December 2019, an increase of approximately 2.8% compared to the year-end 2018 figure of € 22.2 billion.

Aareal Bank AG's property financing portfolio comprises financings of office, residential and retail properties, as logistics properties, hotel properties and other financings; the portfolio is distributed across the regions of Europe, North America and Asia/Pacific.

All in all, the high degree of diversification by region and property type within the property financing portfolio was maintained.

## Financial position

### Money-market liabilities and deposits from the housing industry

Generally, in addition to deposits from housing industry clients and institutional investors, Aareal Bank also uses interbank and repo transactions for short-term refinancing, the latter being used primarily to manage liquidity and cash positions.

As at 31 December 2019, Aareal Bank had € 9.7 billion at its disposal in deposits generated from the business with the housing industry (31 December 2018: € 9.7 billion). Beyond that, there were no repos and no liabilities vis-à-vis Deutsche Bundesbank or the ECB.

### Long-term funding and equity

#### Funding structure

Aareal Bank AG continues to be solidly funded, a development visible by its major share of long-term funding. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues. The latter include subordinated liabilities and regulatory Additional Tier 1 instruments.

The long-term refinancing portfolio totalled € 21.3 billion as at 31 December 2019 (31 December 2018: € 20.4 billion), comprising € 16.0 billion (2018: € 15.0 billion) in Mortgage Pfandbriefe and Public Sector Pfandbriefe, € 4.6 billion (2018: € 4.7 billion) in unsecured funding, € 0.4 billion (2018: € 0.4 billion) in subordinated funding, plus € 0.3 billion (2018: € 0.3 billion) in Additional Tier 1 capital.

The Liquidity Coverage Ratio (LCR) at Group level exceeded 150% on the reporting days during the period under review.

#### Refinancing activities

Throughout the financial year 2019, Aareal Bank Group was able to raise liquidity in the amount of € 2.9 billion on the capital market. Of this volume, € 2.2 billion are attributable to Pfandbriefe, € 0.6 billion to senior preferred bonds and € 0.1 billion to senior non-preferred bonds. This figure included two euro-denominated benchmark Mortgage Pfandbrief transactions sized at € 0.75 billion and € 0.5 billion, and one USD 0.6 billion benchmark Mortgage Pfandbrief issue. We also placed a senior preferred € 0.5 billion benchmark issue with national and international investors.

Since we conduct our business activities in a range of foreign currencies, we have secured our foreign currency liquidity over the longer term by means of appropriate measures.

#### Equity

Aareal Bank AG's total equity as disclosed in the statement of financial position amounted to € 1,751.8 million as at the 31 December 2019 reporting date (31 December 2016: € 1,757.8 million).

**Regulatory indicators <sup>1)</sup>**

	31 Dec 2019 <sup>2)</sup>	31 Dec 2018
€ mn		
Common Equity Tier 1 (CET 1)	2,191	2,241
Tier 1 (T1)	2,491	2,541
Total capital (TC)	3,343	3,419
%		
Common Equity Tier 1 ratio (CET 1 ratio)	19.6	17.2
Tier 1 ratio (T1 ratio)	22.3	19.5
Total capital ratio (TC ratio)	29.9	26.2
Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (estimate) <sup>–3)</sup>	13.5	13.2

<sup>1)</sup> Aareal Bank AG utilises the rules set out in section 2a of the KWG in conjunction with Article 7 of the CRR, pursuant to which regulatory indicators of own funds may only be determined at Group level. In this respect, the following disclosures relate to Aareal Bank Group.

<sup>2)</sup> When calculating own funds, annual profits were taken into account, based on the Management Board's proposal for appropriation of profits for the 2019 financial year, and incorporating the pro-rata accrual of net interest payable on the AT1 bond. The appropriation of profits is subject to approval by the Annual General Meeting. The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning the NPL inventory as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account for determining regulatory indicators.

<sup>3)</sup> Underlying estimate, given a 72.5% output floor based on the final Basel Committee framework dated 7 December 2017. The calculation of the material impact upon Aareal Bank is subject to the outstanding EU implementation as well as the implementation of additional regulatory requirements (CRR II, EBA requirements etc.).

**Our Employees****Employee data as at 31 December 2019**

	31 Dec 2019	31 Dec 2018	Change
Number of employees of Aareal Bank AG	904	913	-1.0%
Years of service	13.7 years	14.3 years	-0.6 years
Staff turnover rate	2.3%	1.9%	

The overview of employee key indicators in the "Responsibility" section of the Company's website (<https://www.aareal-bank.com/en/responsibility/reporting-on-our-progress/>) provides more information, including the breakdown by gender, age and region.

**Qualification and training programmes**

Qualified and motivated employees make a decisive contribution to our Company's economic performance and are thus a key factor in its success – as well as a competitive advantage. For this purpose, Aareal Bank Group operates a human resources approach aimed at the further qualification of its managers, experts and employees. In line with the corporate strategy, the human resources policy is continuously developed in a targeted way. Aareal Bank Group supports employees in change processes, and promotes lifelong professional learning.

The Group consistently pursued this strategy throughout the year under review. The Bank focused on specific and generic training measures – for example, in the form of qualification programmes for (agile as well as traditional) project management, as well as supporting measures related to organisational and team development, which were tailored to the Group-wide reorganisation efforts. At Aareon, the training focus was on targeted development measures for managers, comprising training, diagnostics and consulting offers, coaching, training for digital leadership, as well as training measures for traditional and agile project management. Both Aareal Bank and Aareon also attached great importance to further building language and communications skills within the scope of internationalisation: to this end, a digital language learning portal is used, which provides instructions for learning English as well as five other European languages. This learning portal allows all employees throughout the Group to improve their language skills, anywhere (even at home) and at any time.



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The in-service study course Bachelor of Arts Real Estate offered by EBZ for students training to become qualified housing and property specialists was carried out this way for the first time in 2019.

The fourth cross-mentoring programme was initiated at Aareal Bank and Aareon. Cross-mentoring describes the targeted exchange of employees from different companies; it is a personnel development measure aimed at promoting knowledge transfer.

## Promoting the next generation

Promoting the next generation through training is a central element of Human Resources work at Aareal Bank Group. The specialist knowledge required in our business segments requires us to invest continuously – and in a targeted manner – in training the next generation.

Aareal Bank's programme aimed at promoting the next generation comprises not only trainee programmes, but also the dual studies Business Informatics and Business Administration in cooperation with DHBW Mannheim and RheinMain University, as well as the on-the-job Bachelor's degree Business Administration in cooperation with the University of Applied Sciences Mainz. Aareal Bank closely collaborates with universities in the region via various initiatives.

Besides training programmes, Aareon offers the dual courses of study "Business information systems" and "Media, IT and management" as well as various vocational training opportunities for office managers, IT applications developers, or IT systems integrators.

As in previous years, the Bank and Aareon held the Girls' Day as part of its measures for promoting the next generation. Furthermore, Aareon supported the initiative JOBLINGE aimed at socially deprived young citizens. First participants of this programme have meanwhile embarked on their training. To promote trainees and science, Aareon is cooperating with several universities, and supporting students as part of the German scholarship of the Johannes Gutenberg University in Mainz.

## Remuneration system

In addition to a fixed remuneration component, all permanent employees receive performance-based variable remuneration. Salaries are reviewed annually, to ensure that individual remuneration packages are appropriate. The objective is to offer a remuneration level that is both appropriate and attractive to all Group employees.

## Work-life balance

Aareal Bank Group places great importance on supporting its employees to achieve compatibility between career and family. This is emphasised by a broad range of dedicated support services such as partnerships with childcare institutions or service providers for the provision of private childcare, holiday programmes for employees' children, the availability of parent-child workrooms, flexible working policies, part-time positions and the option of mobile working or alternating teleworking for all employees. Another component of improving the work-life balance of the employees consists of services that make it easier to combine working life with the care of those who require it. This includes, among other things, the offer of counselling and support in the event of illness as well as nursing care for close relatives (available throughout Germany), and the option of participating in various training courses for better compatibility between family, care and work. As an innovative company that promotes the digital transformation process holistically and manages the related process of change for its employees, Aareon had already launched the "work4future" project in 2017. Based on the existing principles of a human resources policy aligned to different phases in life, it focuses on flexible work models, smart and effective employee collaboration, and the digital workplace. The works agreement on mobile working was implemented in 2019, increasing our employees' work flexibility. A digital collaboration tool was introduced for internal communications, and the room concepts are continuously being improved within the scope of internal programmes.

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## Health

In order to verify the effectiveness and continuous improvement of occupational safety management, occupational safety committees meet quarterly. These include the respective company doctor and occupational safety specialists, in addition to various company officers.

In order to protect and promote the health of its employees in a targeted manner, Aareal Bank Group offers a comprehensive range of health-promoting measures in the areas of information, prophylaxis, exercise and ergonomics, nutrition, mental health and relaxation that are always based on employees' current needs. In the year under review, these included preventative, individual health consultations held in the Bank on various topics, workshops on topics such as relaxation, nutrition and fasciae, stress prevention and management measures, health checks, colon cancer screening, skin screenings and flu vaccinations. In 2019, Aareal's occupational health management implemented numerous measures for supporting employees in a digital working world.

## Risk Report

Aareal Bank AG is the parent company of Aareal Bank Group. Aareal Bank AG has entered into profit and loss transfer agreements, or control and profit and loss transfer agreements, with numerous Group entities. The economic risks of these entities are thus reflected in Aareal Bank AG's risk profile. Moreover, the funding of Aareal Bank Group is managed centrally by Aareal Bank AG. The parent company therefore monitors and manages the Group's risks, based on uniform, Group-wide policies. Against this background, the risk report provided below outlines the risk management system at Group level.

### Aareal Bank Group Risk Management

The ability to correctly assess risks, and to manage them in a targeted manner, is a core skill in banking. Accordingly, being able to control risks in all their relevant variations is a key factor for a bank's sustainable, commercial success. This economic motivation for a highly-developed risk management system is continuously increased by extensive regulatory requirements for risk management. For this reason, we implemented the new ECB Guidelines on the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP) at the beginning of the year. The comments set out below in the Risk Report take the new guidelines into account.

#### Risk management – scope of application and areas of responsibility

Aareal Bank Group's business activities comprise the Structured Property Financing and Consulting/Services segments. Aareal Bank AG, as the parent entity of the Group, has implemented extensive systems and procedures to monitor and manage the Group's risk exposure.

Uniform methods and procedures are deployed to monitor material risks generally associated with banking business across all entities of Aareal Bank Group. Specific risk monitoring methods have been developed and deployed to suit the relevant risk exposure at the subsidiaries. In addition, risk monitoring for these subsidiaries at Group level is carried out via the relevant control bodies of the respective entity, and Equity Investment Risk Controlling.

Overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank AG. The adjacent diagram provides an overview of the responsibilities assigned to the respective organisational units.

Type of risk	Risk management	Risk monitoring
<b>Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG</b>		
<b>Loan loss risks</b>		
Property Financing	Loan Markets & Syndication Credit risk Project & Credit Portfolio Management Credit Transaction Management Workout	Risk Controlling    Second Line of Defence (NPL)
Treasury business	Treasury	Risk Controlling
Country risks	Treasury Credit risk Credit Transaction Management	Risk Controlling
Interest rate risk in the banking book (IRRBB)	Treasury; Transaction Committee	Risk Controlling, Finance & Controlling
Market risks	Treasury; Transaction Committee	Risk Controlling
Operational risks	Process owners	Risk Controlling
Investment risks	Group Strategy	Risk Controlling Finance & Controlling Controlling bodies
Real estate risks	Aareal Estate AG	Risk Controlling
Business and strategic risks	Group Strategy	Risk Controlling
Liquidity risks	Treasury	Risk Controlling
<b>Process-independent monitoring: Internal Audit</b>		

The Management Board formulates the business and risk strategies, as well as the so-called Risk Appetite Framework. For this purpose, “risk appetite” means the maximum risk exposure where the Bank's continued existence is not threatened, even in the event of risks materialising. For individual business units (the “First Line of Defence”), the Risk Appetite Framework defines guidelines for the independent and responsible handling of risks.

The risk monitoring function (the “Second Line of Defence”) regularly measures utilisation of risk limits, and reports on the risk situation. In this context, the Management Board is supported by the Risk Executive Committee (RiskExCo). The RiskExCo develops proposals for resolutions in line with delegated tasks, and promotes risk communications and a risk culture within the Bank. The risk management system was supplemented by a recovery plan, in line with regulatory requirements, which comprises the definition of threshold values for key performance indicators – both from an economic and a normative perspective. These are designed to ensure that any negative market developments having an impact upon our business model are identified at an early stage and corresponding action is taken in order to safeguard the sustained continuation of business operations.

On top of this, Group Internal Audit (as the “Third Line of Defence”) reviews the organisational structure and procedures, as well as risk processes – including the Risk Appetite Framework – and assesses their appropriateness. Moreover, internal processes provide for the involvement of the Compliance function whenever there are facts which are compliance-relevant.

In order to efficiently perform its control duties, amongst other measures, the Supervisory Board has established a Risk Committee, whose responsibility includes the risk strategies as well as the management and monitoring of all material types of risk.

## Strategies

The business policy set by the Management Board, and duly acknowledged by the Supervisory Board, provides the conceptual framework for risk management. Taking this as a basis, and strictly considering the Bank's risk-bearing capacity, we have formulated detailed strategies for managing the material types of risk. Taken together, these represent the Group's risk strategy. These strategies are designed to ensure a professional and conscious management of risks. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the Group. They also provide a cross-sectional, binding framework applicable to all divisions. The Bank

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has implemented adequate risk management and risk control processes to implement these strategies, and to safeguard the Bank's risk-bearing capacity.

The business strategy and the risk strategies are subject to review on an ongoing basis, and are updated if necessary. Besides the regular review (and, if appropriate, adjustment) of the business strategy (and consequently, the Group risk strategy), the Bank's risk-bearing capacity is validated at least once a year. For this purpose, the appropriateness of risk measurement methods, processes, and risk limits is examined in particular. During the financial year under review, the strategies were adopted by the Management Board, duly noted, and approved by the Supervisory Board.

The Bank has defined escalation and decision-making processes to deal with limit breaches. Risk Controlling prepares timely and independent risk reports for the Management Board.

Aareal Bank Group maintains a decentralised Internal Control System (ICS), with control activities and results being outlined in the Written Set of Procedural Rules. These describe individual processes of divisions, subsidiaries, or other units. Internal controls may run upstream, downstream, or in parallel to workflows; this applies both to automatic control and monitoring functions as well as to the respective manual steps. Accordingly, the ICS comprises the entire universe of control activities; its objective is to ensure that qualitative and quantitative standards are adhered to (compliance with legal or regulatory requirements, with limits etc.).

The appropriateness and effectiveness of controls is reviewed on an event-driven basis; in any case, at least once a year. The results are discussed with the corresponding units within the Second and Third Lines of Defence (Risk Controlling, Compliance and Internal Audit), and reported to the Management Board and the Supervisory Board. In the event of any irregularities or violations, depending on the severity of the event, the Management Board (as well as the Supervisory Board, if appropriate) must be notified without delay, so that adequate measures or audit activities can be initiated at an early stage.

### **Risk-bearing capacity and risk limits**

The Bank's ability to carry and sustain risk (as determined within the ICAAP framework) is a core determining factor governing the structure of its risk management system. To ensure its uninterrupted risk-bearing capacity, Aareal Bank Group has adopted a dual management approach comprising two complementary perspectives: the normative and the economic perspective. These perspectives replace the two previous management approaches for risk-bearing capacity – namely, the going-concern approach and the gone-concern approach.

The normative perspective aims to ensure Aareal Bank Group's ability to fulfil all of its regulatory requirements over a multi-year period. This perspective thus accounts for all material risks which may impact upon relevant regulatory indicators over the multi-year planning period.

The normative ICAAP perspective is embedded into Aareal Bank Group's planning process, which – in particular – also includes capital planning. Group planning covers three planning years, it comprises both baseline and adverse scenarios. Results of Group planning are shown as a projected consolidated income statement for Aareal Bank Group. Planning also encompasses the balance sheet structure, as well as key regulatory indicators, plus additional internal management indicators.

Besides the planning process itself, intra-year computation adjustments to Aareal Bank Group's planning process also include the ongoing monitoring of management indicators as well as checking whether limits in the normative perspective are being complied with. Management indicators in the normative perspective (which are being monitored, and for which limits have been set) comprise various regulatory ratios.

We are using the ICAAP economic perspective, whose purpose is to safeguard Aareal Bank Group's economic substance and thus, in particular, to protect creditors against economic losses. We predominantly employ proprietary procedures and methods (agreed upon with regulators) in order to identify and quantify potential economic losses, and to determine the required capital backing.

The purpose of internal capital is to serve as a risk-bearing component under the economic perspective. Within Aareal Bank Group, the current regulatory Tier 1 capital serves as the basis for determining economic aggregate risk cover. Accordingly, available internal capital comprises Common Equity Tier 1 (CET1) capital, supplemented by Additional Tier 1 (AT1) capital. Tier 2 capital, as well as projected results to be incurred during the risk analysis horizon, are not taken into account.

Moreover, the value-oriented approach adopted under the economic perspective requires suitable adjustments to be made to regulatory Tier 1 capital, in order to bring aggregate risk cover into line with the economic assessment. Specifically, this may entail adjustments regarding conservative valuation, or a management buffer.

The taxonomy of potential risks under the economic perspective is largely oriented upon the established classification under the previous going-concern/gone-concern approaches. A change was made in 2019 for credit spread and migration risk in the banking book (CSRBB), which no longer constitutes a separate type of risk but is included in loan loss and market risks, as part of the economic perspective. As a result, the number of risk types for which separate limits are determined has been reduced from eight to seven.

Aareal Bank Group consistently applies a period of 250 trading days as a risk analysis horizon, as well as for the holding period as part of risk models under the economic perspective. To the extent that risks are measured on the basis of quantitative risk models, a uniform observation period of at least 250 trading days (or at least one year) is applied to the risk parameters used. The appropriateness of model assumptions is verified within the scope of validating the corresponding risk models and parameters.

Looking at correlation effects between material types of risk within the framework of the economic ICAAP perspective, Aareal Bank Group has prudently opted for aggregation of risk levels; accordingly, no risk-mitigating correlation effects are being taken into account. Where, for the purposes of calculating risk-bearing capacity, risks are measured on the basis of quantitative risk models, these have been based on a uniform confidence interval of 99.9% since 1 January 2019. Until 31 December 2018, a value of 95% had been applied.

Limits for specific risk types are determined in such a manner that aggregate limits do not exceed economic aggregate risk cover, less a risk buffer designed to cover risks not explicitly covered by limits (e.g. those risks which cannot be sensibly quantified), and to also absorb other fluctuations of internal capital over time. Individual limits are set on the basis of existing risk exposures and historical levels of potential risks, and to an extent that is in line with the Bank's business and risk strategy. Specific limits have been set in a way that each limit is sufficient for utilisation in line with planned business development, as well as for common market fluctuations.

A detailed monthly report provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. These are being monitored as part of daily reporting. No limit breaches were detected during the period under review.

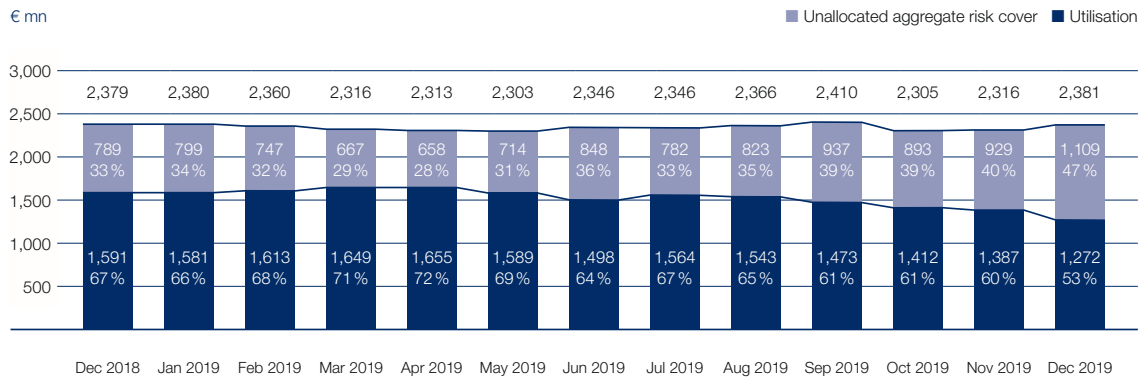
#### Risk-bearing capacity of Aareal Bank Group (ICAAP – economic perspective)

	31 Dec 2019	1 Jan 2019 <sup>1)</sup>
€ mn		
Tier 1 (T1) capital	2,491	2,541
CVA/hidden encumbrances/management buffer	-111	-162
<b>Aggregate risk cover</b>	<b>2,381</b>	<b>2,379</b>
<b>Utilisation of freely available funds</b>		
Loan loss risks	525	685
Interest rate risk in the banking book (IRRBB)	93	101
Market risks	360	530
Operational risks	123	116
Investment risks	30	29
Real estate risks	60	49
Business and strategic risks	81	81
<b>Total utilisation</b>	<b>1,272</b>	<b>1,591</b>
<b>Utilisation (% of aggregate risk cover)</b>	<b>53%</b>	<b>67%</b>

<sup>1)</sup> adjusted for the new confidence interval of 99.9%

Utilisation of aggregate risk cover developed as follows during the period under review:

#### Utilisation of aggregate risk cover during the course of 2019



Since risk cover potential is an inadequate measure to assess the risk-bearing capacity for liquidity risk, we have defined special tools for managing this type of risk. These tools are described in detail in the section “Liquidity risks”.

#### Stress testing

Stress testing, and the analysis of stress test results, form an additional focal aspect of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called “global” stress tests. For instance, the impact of the crisis affecting financial markets and the economy, which broke out in 2007, on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. In the hypothetical scenario, current potential developments are derived from factors such as political developments, and are combined with significant macro-economic deterioration. The stress testing methodology implemented also takes into account the impact of any risk concentrations. Stress scenarios are analysed both from an economic and a normative perspective, with the respective cross-relationships being taken into consideration – meaning that any economic risks which may materialise (from a normative view) over the analysis period being incorporated in the normative perspective, unless they are sufficiently covered already.

Aareal Bank Group uses a Brexit Plan to monitor the impact on Aareal Bank’s risk exposures and business activities. In this plan, the Bank has drawn up various options for action designed to minimise the impact upon the Bank.

The Management Board and the Supervisory Board are informed of the results of stress analyses and the Brexit Plan on a quarterly basis.

#### Lending business

##### Division of functions and voting

Aareal Bank Group’s structural organisation and business processes consider regulatory requirements regarding the organisational structure and procedures in the credit business.

Processes in the credit business are designed to consistently respect the clear functional division of Sales units (“Markt”) and Credit Management (“Marktfolge”), up to and including senior management level. In addition, the Risk Controlling division, which is not involved in making lending decisions, is responsible for monitoring all material risks whilst ensuring an adequate and targeted risk reporting system at a portfolio level.

Lending decisions regarding credit business classified as relevant for the Bank’s risk exposure require two approving votes submitted by a Sales unit and a Credit Management unit. The Bank’s Schedule of Powers defines the relevant lending authorities within Sales units and Credit Management. Where authorised persons are unable to come to a unanimous lending decision, the loan

involved cannot be approved, or must be presented to the next-highest decision-making level for a decision.

The RiskExCo, which has delegated authority to the heads of Risk Controlling, Operations, and Project & Credit Portfolio Management (which are independent of Sales units), is responsible for the approval of counterparty, issuer, or country limits.

We have implemented and documented the clear separation of Sales and Credit Management processes across all relevant divisions.

### **Process requirements**

The credit process comprises the credit approval and further processing phases, each governed by a control process. Credit exposures subject to increased risks involve supplementary processes for intensified handling, the handling of problem loans, and – if necessary – for recognising allowance for credit losses. The corresponding processing principles are laid down in the Bank's standardised rules and regulations. Important factors determining the counterparty credit risk of a credit exposure are identified and assessed on a regular basis, taking into account sector and (where appropriate) country risks. Critical issues regarding an exposure are highlighted, and analysed assuming different scenarios where appropriate.

Suitable risk classification procedures are applied to evaluate risks for lending decisions, as well as for regular or event-driven monitoring of exposures. This classification scheme is reviewed at least once a year; depending on the risk situations, the review cycle may be shortened significantly. Furthermore, the risk assessment results influence pricing.

The organisational guidelines contain provisions governing escalation procedures and further handling in the event of limit breaches, or of a deterioration in individual risk parameters. Measures involved may include the provision of extra collateral, or an impairment test.

### **Early risk detection procedures**

The early identification of credit risk exposure, using individual or combined (early warning) criteria is a core element of our risk management approach.

In particular, the procedures applied for the early detection of risks serve the purpose of identifying borrowers or exposures where higher risks start emerging, at an early stage. For this purpose, we generally monitor individual exposures and the parties involved (such as borrowers or guarantors) regularly throughout the credit term, assessing quantitative and qualitative factors, using instruments such as periodic monitoring and internal ratings. The intensity of the ongoing assessments is based on the risk level and size of the exposure. The Group's risk management processes ensure that counterparty credit risk is assessed at least once a year.

A CRE Credit Risk Committee (CRC) has been established in order to enhance the Bank's procedures for the early detection of risks. The CRC promotes the risk culture by identifying and addressing risk-relevant issues concerning individual credit exposures; the committee is also involved in each credit exposure with mandatory rating that is subject to higher risk exposure. Specifically, the CRC decides upon the exercise of discretion regarding classification of exposures as "normal", "intensified" or "problem loan" handling, as well as approval of action plans. The transfer of know-how is enhanced through the cross-divisional representation on the CRC.

Extensive IT resources are deployed to identify risk positions, and to monitor and measure risks. Overall, the existing set of tools and methods enables the Bank to adopt suitable risk management measures, where required, at an early stage.

Actively managing client relationships is crucially important in this context: approaching clients in time to jointly develop a solution to any problems which may arise. Where necessary, we muster the support of experts from the independent restructuring and recovery functions.

### **Risk classification procedures**

Aareal Bank employs risk classification procedures tailored to the requirements of the respective asset class for the initial, regular, or event-driven assessment of counterparty credit risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, and for annual validation, lies with two separate divisions outside the Sales units.

The ratings determined using internal risk classification procedures are an integral element of the Bank's approval, monitoring, and management processes.

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### Property financing business

The Bank employs a two-level risk classification procedure for large-sized commercial property finance exposures, specifically designed to match the requirements of this type of business.

In a first step, the client's probability of default (PD) is determined using a rating procedure. The method used in this context comprises two main components, a property rating and a corporate rating.

The relative impact of the two components on the rating result is determined by the structure of the exposure concerned. The client's current and future default probability is determined based on specific financial indicators, together with qualitative aspects and expert knowledge.

The second step involves calculating the loss given default (LGD). The LGD estimates the extent of the economic loss in the event of a borrower defaulting. In simple terms, this is the amount of the claim not covered by the proceeds from the realisation of collateral.

When evaluating collateral, haircuts are applied or recovery rates used, depending on the type of collateral involved and specific realisation factors. For financings of domestic properties, recovery rates are taken from a pool of data used across the Bank, whilst recovery rates for international properties are derived using statistical methods, given the low number of realisations.

The expected loss (EL) in the event of default of an exposure is determined as the product of PD and LGD. As a risk parameter related to the financing, EL is used as an input factor for the tools used to manage the property financing business.

### Financial institutions

Aareal Bank employs an internal rating procedure for financial institutions, which incorporates qualitative and quantitative factors as well as our client's group affiliation, to classify the risk exposure to banks, financial services providers, securities firms, public-sector development banks, and insurance companies. Financial institutions are assigned to a specific rating grade by way of assessing relevant financial indicators and taking into account expert knowledge.

### Sovereign states and local authorities

In addition, Aareal Bank Group employs internal rating methods for sovereign borrowers and regional governments, local and other public-sector entities. In this context, rating grades are assigned using clearly-defined risk factors, such as fiscal flexibility or the level of debt. The expert knowledge of our rating analysts is also taken into account for the rating.

In general, the risk classification procedures employed by the Bank are dynamic methods which are permanently adapted to changing risk structures and market conditions.

## Trading activities

### Functional separation

We have implemented a consistent functional separation between Sales units and Credit Management for the conclusion, settlement and monitoring of trading transactions, covering the entire processing chain.

On the Sales side, the processing chain comprises the Treasury division, whilst Credit Management tasks are carried out by the independent Operations and Risk Controlling divisions. Beyond this, Finance & Controlling and Audit are responsible for tasks not directly related to processes.

We have laid down organisational guidelines providing for binding definitions of roles and responsibilities along the processing chain; with clearly defined change processes.

The detailed assignment of responsibilities is outlined below.

Treasury is responsible for risk management and trading activities as defined by the Minimum Requirements for Risk Management ("MaRisk"). Treasury is also responsible for asset/liability management, and for managing the Bank's market and liquidity risk exposures. In addition, we have established a Transaction Committee, to develop strategies for the Bank's asset/liability management and proposals for their implementation. The Committee, which comprises the Management Board member responsible for Treasury, the Head of Treasury, and other members appointed by the Management Board, meets on a weekly basis.

Operations is responsible for controlling trading activities, confirming trades to counterparties, and for trade settlement. The division is also responsible for verifying that trades entered into are in line



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with prevailing market conditions, as well as for the legal assessment of non-standard agreements, and of new standard/master agreements.

To assess counterparty credit risk in the trading business, Operations prepares a rating for all counterparties and issuers on a regular or event-driven basis. The rating is a key indicator used to determine the limit for the relevant counterparty or issuer.

The RiskExCo is responsible for voting on all limit applications. The Committee has delegated corresponding authority to the Heads of Risk Controlling, Operations, and Project & Portfolio Management, who are responsible for conducting annual limit reviews, as well as for reducing (or revoking) counterparty or issuer limits whenever required.

The tasks of the Risk Controlling division comprise identifying, quantifying and monitoring market price, liquidity and counterparty credit risk exposure from trading activities, and the timely and independent risk reporting to senior management.

### **Process requirements**

Processes are geared towards ensuring end-to-end risk management, from conclusion of the trade right through to monitoring portfolio risk. The monitoring and reporting function comprises deploying adequate risk measurement systems, deriving limit systems, and ensuring the transparency of Aareal Bank Group's overall risk exposure from trading activities, in terms of scope and structure.

Change processes (as defined in section AT 8 of the MaRisk) are consistently measured via Group-wide framework directives, with the RiskExCo involved in all cases. Moreover, processes and systems are designed in a way that allows to incorporate new products into the risk monitoring system swiftly and adequately, in order to ensure the flexibility of the Sales units in their business activities.

A standardised process exists for the intensified handling of counterparties and issuers, and for dealing with problems. This process comprises identifying early warning indicators, applying them for the purposes of risk analysis, as well as determining further action to be taken. In the event of counterparty or issuer default, the RiskExCo will be involved in devising an action plan, in cooperation with the Bank's divisions involved.

Escalation and decision-making processes have been set out to deal with limit breaches.

## **Loan loss risks**

### **Definition**

Aareal Bank defines loan loss risk as the risk of losses being incurred due to (i) a deterioration in a business partner's credit quality (migration risk); (ii) a business partner defaulting on contractual obligations; (iii) collateral being impaired; or (iv) a risk arising upon realisation of collateral. Both credit business and trading activities may be subject to counterparty credit risk. Counterparty credit risk exposure from trading activities may refer to risk exposure vis-à-vis counterparties or issuers. Country risk is also defined as a form of counterparty credit risk.

### **Credit risk strategy**

Based on the Bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. The credit risk strategy serves as a strategic guideline for dealing with each respective category of risk within Aareal Bank Group; it also provides a binding, overarching framework applicable to all divisions.

The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the Bank's risk-bearing capacity and its business environment; amendments will be made as necessary. The associated process is instigated by senior management, and implemented by Risk Controlling, which submits a proposal, which has been agreed upon with all divisions, to senior management. The Supervisory Board then duly acknowledges and approves the credit risk strategy adopted.

Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment (as in the case of the financial markets crisis).

## Risk measurement and monitoring

Regulatory requirements are taken into account for the organisation of operations and workflows in the credit and trading businesses.

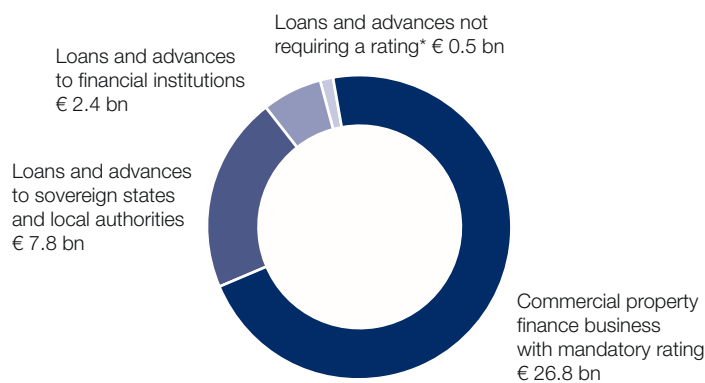
Processes in the credit and trading businesses are designed to consistently respect the clear functional division of Sales units ("Markt") and Credit Management ("Marktfolge"), up to and including senior management level. The independent Risk Controlling division is responsible for identifying, quantifying and monitoring all material risks at portfolio level, and for maintaining a targeted risk reporting system.

Aareal Bank employs different risk classification procedures tailored to the requirements of the respective type of business for the initial, regular, or event-driven assessment of counterparty credit risk. Forward-looking as well as macro-economic information is taken into consideration for risk classification procedures, and in the valuation of collateral. The respective procedures and parameters are subject to regular review and adjustment. Responsibility for development, quality assurance, and monitoring implementation of procedures, is outside the Sales units.

### Breakdown of on-balance sheet and off-balance sheet business

by rating procedure, € bn

31 Dec 2019

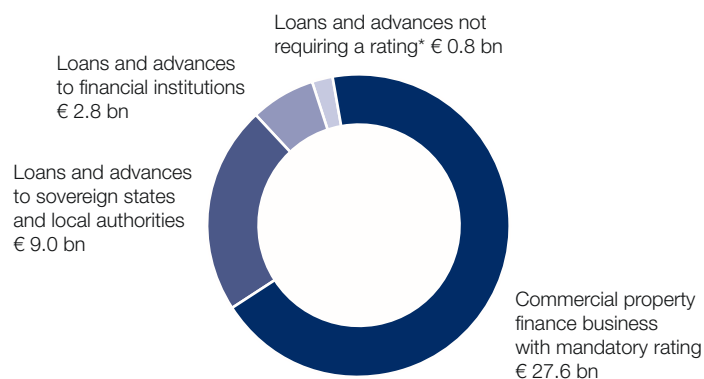


\* Including the private client business of former WestImmo

### Breakdown of on-balance sheet and off-balance sheet business

by rating procedure, € bn

31 Dec 2018



\* Including the private client business of former WestImmo

Methods used to measure, control and monitor concentration and diversification effects on a portfolio level include two different credit risk models. Based on these models, the Bank's decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business with financial institutions. The models in question allow the Bank to include in particular, rating changes and correlation effects in the assessment of the risk concentrations.

Within the process-oriented monitoring of individual exposures, the Bank uses various tools to monitor exposures on an ongoing basis: besides the tools already described, this includes rating reviews, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures. The intensity of loan coverage is oriented upon the credit risk exposure. Intensified handling triggers recognition of loss allowance, in the amount of lifetime expected credit loss for the financial instrument concerned (Stage 2).

The following tables provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating class and loss allowance stages, in line with credit risk management at Group level. Figures are based on Aareal Bank Group's internal default risk rating classes. The default definition follows the definition pursuant to Article 178 of the CRR, which is decisive for management purposes. Qualitative default definitions were further refined during the year under review, without any material impact. Accelerated de-risking led to a reduction in defaulted commercial property finance business with mandatory rating by approximately € 0.6 billion.

#### On-balance sheet commercial property finance business with mandatory rating

€ mn	31 Dec 2019					31 Dec 2018				
	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total
Class 1										
Class 2	62				62	117				117
Class 3	430			2	432	255				255
Class 4	1,368				1,368	1,486				1,486
Class 5	3,447			495	3,942	3,566			94	3,660
Class 6	4,300	20		64	4,384	3,966	21		256	4,243
Class 7	3,872			75	3,947	3,420				3,420
Class 8	6,051	35		209	6,295	5,166	112		181	5,459
Class 9	2,936			56	2,992	3,463	42		116	3,621
Class 10	860	344			1,204	1,510	28			1,538
Class 11	174				174	285	91		39	415
Class 12	1	16			17	531	62			593
Class 13		60			60		66			66
Class 14										
Class 15									3	3
Defaulted			935	149	1,084			1,564	22	1,586
<b>Total</b>	<b>23,501</b>	<b>475</b>	<b>935</b>	<b>1,050</b>	<b>25,961</b>	<b>23,765</b>	<b>422</b>	<b>1,564</b>	<b>711</b>	<b>26,462</b>

<sup>1)</sup> fvpl = at fair value through profit and loss (in accordance with IFRSs)

**Off-balance sheet commercial property finance business with mandatory rating**

€ mn	31 Dec 2019					31 Dec 2018				
	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total
Classes 1-2										
Class 3	22				22					
Class 4	25				25	39				39
Class 5	63			17	80	32			6	38
Class 6	117				117	190			25	215
Class 7	141			25	166	175				175
Class 8	271	4			275	312	5			317
Class 9	101				101	120				120
Class 10	34				34	75				75
Class 11	1				1	5				5
Class 12						29				29
Classes 13-15										
Defaulted			2		2			78		78
<b>Total</b>	<b>775</b>	<b>4</b>	<b>2</b>	<b>42</b>	<b>823</b>	<b>977</b>	<b>5</b>	<b>78</b>	<b>31</b>	<b>1,091</b>

<sup>1)</sup> fvpl = at fair value through profit and loss (in accordance with IFRSs);  
loan commitments for parts of loans earmarked for syndication

**On-balance sheet loans and advances to financial institutions**

€ mn	31 Dec 2019					31 Dec 2018				
	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total
Class 1	815				815	1,242				1,242
Class 2						32				32
Class 3	172				172	15				15
Class 4	82				82	85				85
Class 5	49				49	514				514
Class 6						100				100
Class 7	836				836	387			35	422
Class 8	417				417	284				284
Class 9	35				35	16			43	59
Class 10	26				26	25			26	51
Classes 11-18										
Defaulted										
<b>Total</b>	<b>2,432</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,432</b>	<b>2,700</b>	<b>-</b>	<b>-</b>	<b>104</b>	<b>2,804</b>

<sup>1)</sup> fvpl = at fair value through profit and loss (in accordance with IFRSs)

**On-balance sheet loans and advances to sovereign states and local authorities**

€ mn	31 Dec 2019					31 Dec 2018				
	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total	Stage 1	Stage 2	Stage 3	fvpl <sup>1)</sup>	Total
Class 1	2,505				2,505	2,621				2,621
Class 2	2,680			65	2,745	2,666			76	2,742
Class 3	739			67	806	797			70	867
Class 4	100				100	145			32	177
Class 5	176				176	239			62	301
Class 6	262				262	436				436
Class 7	189				189	163			105	268
Class 8	6				6					
Class 9	925	125			1,050	711	805		89	1,605
Classes 10-20										
Defaulted										
<b>Total</b>	<b>7,582</b>	<b>125</b>	<b>-</b>	<b>132</b>	<b>7,839</b>	<b>7,778</b>	<b>805</b>	<b>-</b>	<b>434</b>	<b>9,017</b>

<sup>1)</sup> fvpl = at fair value through profit and loss (in accordance with IFRSs)

Monthly reporting covers the material aspects of credit risk; it is supplemented by detailed information – which also fully covers specific credit portfolio developments (broken down by country, property and product type, risk classes, and collateral categories, for example), in line with regulatory requirements – at least on a quarterly basis. Risk concentrations are being taken into account in particular.

Trading activities are restricted to counterparties for whom the requisite limits are in place. All trades are immediately taken into account for the purposes of borrower-related limits. Compliance with limits is monitored in real time by Risk Controlling. Persons holding position responsibility are informed about relevant limits and their current usage, regularly and without delay.

In principle, Aareal Bank pursues a 'buy and manage' strategy in managing its credit portfolio – with the primary objective of holding the majority of loans extended on its balance sheet until maturity; at the same time, targeted exit measures are deployed for actively managing the portfolio and the risks involved.

In summary, during the period under review, the existing set of tools and methods continued to enable the Bank to adopt suitable risk management or risk mitigation measures, where required, at an early stage.

### Credit risk mitigation

The Bank accepts various types of collateral to reduce default risk exposure. This includes impersonal collateral, such as liens on immobile (property) and mobile assets; liens on receivables, such as rents; and third-party undertakings, such as guarantees.

As an international property finance house, Aareal Bank focuses on property when collateralising loans and advances. As a rule, loans are granted and the security interest perfected in accordance with the jurisdiction in which the respective property is located.

Mortgage lending values or fair values are set or determined in accordance with the responsibilities for decision-making on lending, and form an integral part of the lending decision. The values to be determined by the Bank are generally pegged on the valuation prepared by a valuer, which is subject to an internal plausibility check. Any diverging assessment must be substantiated in writing. In any case, the market and mortgage lending values determined by the Bank must not exceed the values assessed by independent internal or external valuers.

To mitigate credit risk, the Bank also accepts collateralisation through a pledge of shareholdings in property companies or special purpose entities not listed on a stock exchange. The Bank has set out detailed provisions governing the valuation of such collateral.

The Bank also accepts guarantees or indemnities as well as financial collateral (such as securities or payment claims) as standard forms of collateral. The collateral value of the indemnity or guarantee is determined by the guarantor's credit quality. For this purpose, the Bank differentiates between banks, public-sector banks, and other guarantors. The value of financial collateral is determined according to the type of collateral. Haircuts are generally applied when determining the value of guarantees/indemnities and financial collateral.

The defined credit processes provide for the regular review of collateral value. The risk classification is adjusted in the event of material changes in collateral value. An extraordinary review of collateral is carried out where the Bank becomes aware of information indicating a negative change in collateral value. Moreover, the Bank ensures that disbursement is only made after the agreed conditions for payment have been met.

Collateral is recorded in the Bank's central credit system, including all material details.

### **Credit risk mitigation for trading activities**

To reduce counterparty risk in Aareal Bank's trading business, the master agreements for financial derivatives and master agreements for securities repurchase transactions (repos) used by the Bank<sup>1</sup> provide for various credit risk mitigation techniques, via mutual netting framework agreements.

The master agreements for financial derivatives used by the Bank contain netting framework agreements at a single transaction level (so-called "payment netting"), and arrangements for the termination of individual transactions under a master agreement (so-called "close-out netting").

In general, all master agreements are based on the principle of a common agreement. This means that, in the case of a termination, the individual claims are netted, and that only such net amount can and may be claimed with regard to the defaulted counterparty. This claim must not be affected by any insolvency, i.e. it must be legally valid and enforceable. This, in turn, means that the jurisdictions concerned must recognise the concept of a common agreement which protects the net amount of the claim from imminent access by the insolvency administrator.

Above all, the close-out netting is subject to (international) legal risks. The Bank reviews these legal risks by reference to legal opinions regarding the validity and enforceability of mutual netting framework agreements in the case of a counterparty's insolvency. These legal opinions are evaluated based on various criteria such as product type, jurisdiction of the registered office and branch office of the counterparty, individual contract supplements and other criteria, and using a database developed for this purpose. In doing so, the Bank decides for each individual transaction whether or not netting is possible. The Bank uses eligible bilateral netting framework agreements within the meaning of the CRR for all transactions with financial institutions; in many cases there are additional collateral agreements which further reduce the relevant credit risk.

The Bank enters into repo transactions both on a bilateral basis and via Eurex Clearing AG as a central counterparty. For repo transactions, depending on the counterparty, payment or delivery netting is agreed upon. Master agreements for repo transactions generally contain provisions on close-out netting. The Bank does not use the option permitted by regulatory authorities to reduce capital requirements for repo transactions.

Furthermore, counterparty risk is reduced through derivatives settlement via central counterparties (CCPs): Aareal Bank uses Eurex Clearing AG and LCH.Clearnet Limited.

The Bank uses an internal rating system to assess the credit quality of counterparties. Operations is responsible for the daily valuation of the Bank's trades, including collateral accepted or pledged, and using validated valuation procedures.

Cash collateral only is accepted for derivatives transactions; such collateral is pledged in regular intervals, as set out in the individual agreements. Repo transactions are usually collateralised through securities, pledged on a daily basis.

Some collateral agreements provide for higher collateral levels in the event of material downgrade to a contracting party's rating.

<sup>1</sup> Any comments below referring to the German Master Agreement on Financial Derivatives (Deutscher Rahmenvertrag für Finanztermingeschäfte – "DRV") also pertain to the master agreement issued by the International Swaps and Derivatives Association Inc. (ISDA) (the "ISDA Master Agreement"). Both agreements are standardised agreements recommended by leading associations – among others, by the Association of German Banks (Bundesverband deutscher Banken – "BdB").

## Country risks

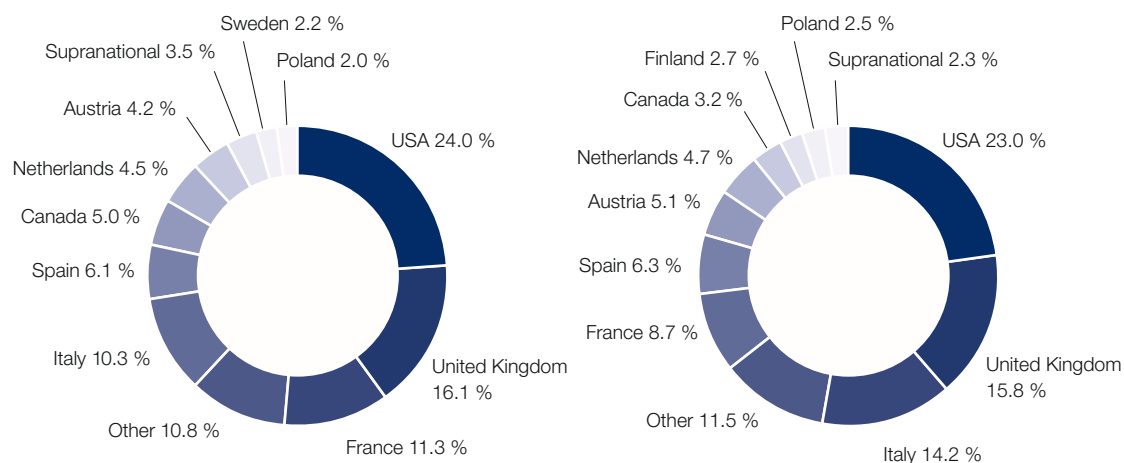
Our comprehensive approach to risk management also includes measuring and monitoring country risk exposure. When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk that a counterparty could become unable to meet its payment obligations as a result of government action, despite being willing and able to pay, due to restrictions being imposed on making payments to creditors (transfer risk). Country risk exposure is managed using a cross-divisional process. The respective country limits are determined on the basis of a country risk assessment by the Bank's senior management. The Risk Controlling division is responsible for the continuous monitoring of country limits and limit utilisation, and for periodical reporting.

The diagram below illustrates the risk exposure by country (comprising receivables and off-balance sheet obligations) in the Bank's international business, at year-end. In the property financing business, country exposures are allocated by location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile. This reflects the exposure of the property finance business, as well as the activities of Treasury.

### Breakdown of country exposure in the international business

%

31 Dec 2019 | 31 Dec 2018



## Interest rate risk in the banking book

### Definition

Interest rate risk in the banking book (IRRBB) is defined as the risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, caused by yield curve shifts.

Specifically, for Aareal Bank this includes:

- ◆ risks arising from maturity transformation in the event of yield curve shifts (so-called gap risk), which, in turn, are broken down into:
  - » risks from cash flows which are sensitive to interest rates, relative to the general yield curve (interest rate risk or repricing risk);
  - » risks arising from the valuation of future cash flows, relative to the general yield curve (yield curve risk);
- ◆ risks from cash flows which are sensitive to interest rates, in terms of spreads to the general yield curve (basis risk);
- ◆ risks from explicit and implied options (option risk);

- ◆ risks arising from changing valuation of pension liabilities (pension risk);
- ◆ risks from fluctuations in the value of fund assets (fund risk); and
- ◆ risks from changes in Aareal Bank's specific funding spreads (funding risk).

### Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and the exposure to interest rate risk in the banking book on a daily basis.

The VaR concept has been broadly accepted as the predominant method for measuring economic interest rate risk in the banking book. VaR quantifies risk as the maximum loss that will occur within a certain period of time, and given a defined probability.

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9% confidence interval under the economic perspective.

By their very nature, VaR calculations are based on numerous assumptions regarding the future development of the business, and the related cash flows. Key assumptions used include current account balances and deposits at notice which are factored into calculations for a period of up to ten years, using the average residual amount of deposits observed in the past. Loans are taken into account using their fixed-interest period (for fixed-rate exposures) or using their expected maturity (variable-rate exposures). Aareal Bank Group's consolidated equity is not taken into account as a risk-mitigating item. This tends to overstate VaR, demonstrating the conservative approach adopted in our risk measurement processes.

### Interest rate sensitivity

An additional instrument used to quantify interest rate risk exposure is the calculation of interest rate sensitivity, expressed by the so-called "delta" parameter. The first step to determine this parameter requires calculating the present values of all asset and equity/liability items on the statement of financial position. In a second step, the interest rates of yield curves used for this calculation are subjected to a one basis point parallel shift up (a method known as the "key rate method"). Delta is the present value of the profit or loss resulting from this yield curve change.

### Present-value impact of an interest rate shock

The following tables show the changes in present value as prescribed by BaFin circular 06/2019, applying EBA guidelines EBA/GL/2018/02 on controlling interest rate risk in the banking book (IRRBB).

The standard test prescribed therein outlines present value changes in the banking book in the event of a maximum 200 basis point parallel shift for each currency. As in the previous years, the ratio of the aggregate results to Aareal Bank Group's regulatory capital is clearly below the prescribed threshold of 20%.

	31 Dec 2019		31 Dec 2018	
	-200 bp	+200 bp	-200 bp	+200 bp
€ mn				
EUR	37	5	-140	204
GBP	-20	21	-12	-12
USD	-28	18	-10	-10
Other	-13	8	-12	-12
<b>Total</b>	<b>-24</b>	<b>52</b>	<b>-174</b>	<b>170</b>
<b>Percentage ratio to regulatory capital</b>	<b>0.7</b>	<b>1.6</b>	<b>5.3</b>	<b>5.2</b>



Furthermore, present value changes are determined (and their ratio to Tier 1 capital shown) for six early-warning indicators, applying the prescribed scenarios. The ratio of the aggregate result to Aareal Bank Group's Tier 1 capital is clearly below the prescribed threshold of 15%.

	31 Dec 2019
€mn	
Parallel shock up	-30
Interest rate coefficient for parallel shock up (%)	1.2
Parallel shock down	52
Interest rate coefficient for parallel shock down (%)	2.1
Steeper shock	38
Interest rate coefficient for steeper shock (%)	1.5
Flattener shock	-44
Interest rate coefficient for flattener shock (%)	1.8
Short rates shock up	-40
Interest rate coefficient for short rates shock up (%)	1.6
Short rates shock down	51
Interest rate coefficient for short rates shock down (%)	2.0
<b>Tier 1 (T1) capital</b>	<b>2,491</b>

## Market risks

### Definition

Market risks are broadly defined as the threat of losses due to changes in market parameters; this refers to market risks which are not assigned to the IRRBB. In particular, this also encompasses any type of spread risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, and which are neither included in IRRBB nor in counterparty credit risk. Specifically, for Aareal Bank this includes:

- ◆ risks resulting from fluctuations of spot foreign exchange (FX) rates (spot FX risk);
- ◆ risks resulting from fluctuations of forward foreign exchange rates (forward FX risk); and
- ◆ risks from the regulatory review of the trading book (Financial Risk in the Trading Book – FRTB).

Being authorised to maintain a trading book, Aareal Bank AG is the Group entity that is in a position to assign transactions to the trading portfolio as defined by the CRR. Given that no such trades were concluded during the financial year under review, trading book risks played a negligible role in the overall risk scenario during the period.

Commodities are irrelevant for the Bank's business. Exchange rate risks are largely eliminated through hedges.

Various risks previously shown under CSRBB have been included under market risks upon introduction of the economic perspective for risk-bearing capacity under the ICAAP. Specifically, for Aareal Bank this includes:

- ◆ valuation risks due to changes in credit spreads (credit spread risk);
- ◆ specific price risks from the bond portfolio, wherein the bonds are mainly sovereign bonds (sovereign risk);
- ◆ risks from adjustments to the credit valuation of OTC – derivatives (CVA risk).

Risks from the rating migration of loans (migration risk), previously also included in CSRBB, are now part of credit risks. To differentiate spread risks (credit spread risk and sovereign risk) in terms of their credit risk exposure, reported market risk is adjusted accordingly.

### Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and exposure to other market risks on a daily basis.

The VaR concept has been broadly accepted as the predominant method for measuring economic market risk. VaR quantifies risk as the maximum loss that will occur within a certain period of time, and given a defined probability.

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9% confidence interval;

Furthermore, in addition to the risk category limit, a separate trading limit has been determined for Aareal Bank AG, as an institution authorised to maintain a trading book.

### Backtesting

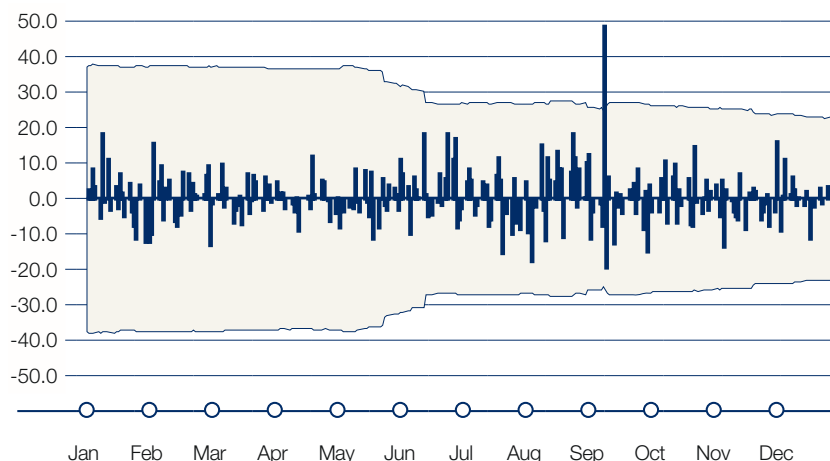
The quality of forecasts made using statistical models is checked through a monthly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as “clean backtesting”). In line with the selected confidence level of 99.9%, only a small number of events are expected to break out of the VaR projection ( $\leq 1$  for a 250-day period).

The backtesting exercise shown below comprises all risk positions subject to daily changes from the “Market risks” category.

No negative outliers were observed at Group level during the past 250 trading days, affirming the high forecasting quality of the VaR model we use.

### Present values and 1-day VaR during the course of 2019

€ mn      □ Value at Risk (99.9%, 1-day holding period)      ■ PV change (1 day)



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## Operational risks

### Definition

The Bank defines operational risk as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. To the extent that they are caused by operational risks, model and reputational risks are also taken into consideration within this type of risk. Systemic risks (or their impact on operational risks) are not affected by this.

### Risk measurement and monitoring

It is the objective of the policy pursued by Aareal Bank to achieve a risk-minimising or loss-limiting effect at an early stage by employing a pro-active approach.

The Bank currently uses the following risk control tools to manage operational risks:

- ◆ Self-assessments: analysis thereof can provide management with indicators of any potential risks within the organisational structure.
- ◆ Risk inventories that include a periodic systematic identification and compilation of all relevant risks.
- ◆ A loss database, in which relevant damages incurred are reported, and in which they can be monitored until they are officially closed.

By means of this control toolkit, decentralised data capture as well as centralised and timely compilation of all material operational risks across the Group are ensured.

The three tools described above are used to prepare the regular risk reporting to the Bank's senior management. The responsibility for implementing operative risk-reducing measures rests with those responsible for the Bank's risk management. The utilisation of freely available funds for operational risks – as part of the Bank's risk-bearing capacity – are determined using the regulatory standardised approach.

In addition to the reports prepared from the tools stated above, suitable and plausible stress tests are conducted every quarter. These are hypothetical and historical scenarios as well as sensitivity analyses on the risk inventories. The results of the stress tests are reported regularly to the Management Board and serve as an indicator for potential developments within the operational risks that could jeopardise the continued existence of the Group.

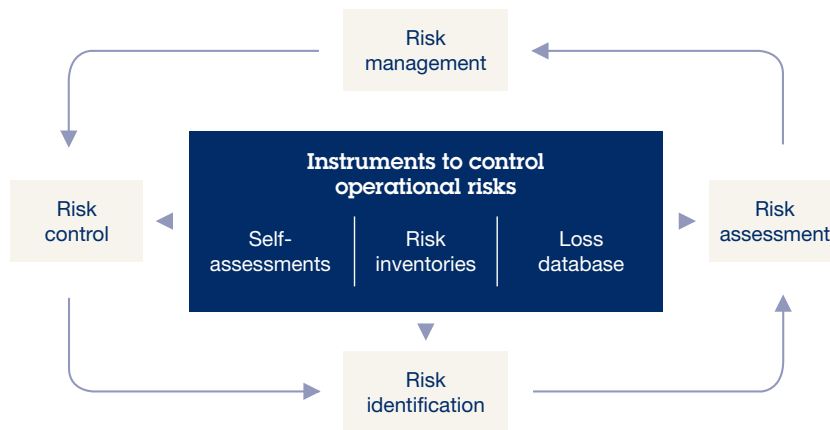
Aareal Bank's legal department deals with any litigation the Bank is involved in, as well as with any legal issues of fundamental importance, where necessary, using the support of external lawyers.

Legal also compiles all information concerning any legal disputes involving Aareal Bank Group, whether in or out of court. To this extent, the involvement of the legal department is based on corresponding Group-wide guidelines. The Bank's decentralised operating legal entities, as well as the legal departments of subsidiaries submit quarterly reports on legal risks identified to Aareal Bank's legal department; where particular risks have occurred, such reports are submitted on an event-driven basis. When required, Aareal Bank's legal department discusses and coordinates any concrete measures with the reporting unit.

The legal department reports to the Management Board, (at least) on a quarterly basis, as well as on an event-driven basis. Moreover, information about legal risks is included in operational risk reporting.

Analyses conducted using the instruments employed have shown that the Bank is not exposed to disproportionate operational risks; nor did they indicate any material risk concentration. Even though loss cases were recorded in the loss database during the financial year under review, the aggregate impact of such losses amounted to less than 10% of the regulatory capital to be maintained for operational risks.

## Management of operational risks



Further to these tools, the Bank reviews relevant individual scenarios, and implements any measures required, on the basis of external data. Taken together, these tools for managing operational risks result in an integrated control circuit which leads to risk identification, evaluation, and management – through to risk control.

Tools to control operational risk are supplemented by a system to manage and monitor outsourced activities and processes (outsourcing), whereby the relevant organisational units regularly assess the performance of outsourcing providers, using defined criteria. The results of this process, and actions taken, are communicated to the Bank's senior management within the scope of operational risk reporting, thus allowing for risk-mitigating steps to be taken where needed.

## Investment risks

### Definition

Aareal Bank defines investment risk as the threat of unexpected losses incurred due to an impairment of the investment's carrying amount, or a default of loans extended to investees. The concept of investment risk also encompasses additional risks arising from contingencies vis-à-vis the relevant Group entities.

### Risk measurement and monitoring

All relevant Group entities are subject to regular audits, including a review and assessment of their risk situation within the framework of risk measurement and monitoring. Due to the special character of some exposures (e.g. marketing risks), special methods and procedures are employed to deal with investment risk. The Bank uses an internal valuation method to quantify investment risk, and to include it in the calculations of the Bank's ability to carry and sustain risk, and for the purpose of limitation. The limit defined for investment risk was always complied with during the financial year under review.

The existing procedures used to measure and monitor risk exposure are supplemented by subjecting the equity portfolio to regular stress testing.

Strategy Development, as well as Finance & Controlling and Risk Controlling, are responsible for measuring and monitoring investment risk exposure.

Risk Controlling is responsible for submitting a quarterly equity investment risk report to the Bank's Management Board.

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## Property risks

### Definition

We define property risk as the threat of unexpected losses arising from changes in the value of property held by the Bank, or by fully-consolidated subsidiaries.

Due to the special character of property risk (involving marketing risks, for example), special methods and procedures are employed to deal with investment risk. All relevant property holdings are subject to regular audits, including a review and assessment of their risk situation. Property risks increased during the period under review, as a result of the acquisition of property SPVs from former credit exposures to Italy.

### Risk measurement and monitoring

In order to measure and monitor risks, property yields are analysed for different regions, and over the time horizons available: on this basis, potential yield increases over a one-year horizon are determined applying a 99.9% confidence interval. The loss in a property's value results from the difference between the current market value and the property value adjusted for the yield increase.

## Business and strategic risks

### Definition

Business and strategic risk is defined as the risk of unexpected losses, usually brought about by a decline in profits due to income falling short of expectations, whereby the shortfall cannot be compensated for by cost reductions. Strategic risk may emerge from changes in the competitive or regulatory environment, or due to unsuitable positioning in the macroeconomic environment.

### Risk measurement and monitoring

In this context, we distinguish between investment risk and allocation risk, whereby allocation risk is already covered by various planning scenarios, and is thus incorporated in aggregate risk cover.

Investment risk is measured across segments: it is quantified assuming that additional upfront investment is required to establish an investment opportunity which was previously unavailable. Such upfront investment is assumed to represent potential risk.

## Liquidity risks

### Definition

Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met in full or on time. Aareal Bank Group's liquidity risk management system is designed to ensure that the Bank has sufficient cash and cash equivalents to honour its payment obligations at any future point in time. The risk management and monitoring processes have been designed to cover refinancing and market liquidity risks in addition to liquidity risk in the narrower sense.

### Risk measurement and monitoring

Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring, including a daily liquidity report submitted to Treasury, and a contribution to the monthly risk report to the entire Management Board. The following tools are used for this purpose:

### Cash flow forecast

We have developed a cash flow forecast, tracking cash flows from all balance sheet items and derivatives, on a daily basis, over a ten-year period. This liquidity risk information helps to assess the Bank's short-term liquidity position, broken down by currency or product. Strategic liquidity is taken into account using this ten-year cash flow profile. We use statistical modelling to incorporate the expected cash flow profile of products without a fixed contractual lifetime.

### Liquidity run-off profile

The appropriateness of the Bank's liquidity is assessed using a liquidity run-off profile: the aggregate of all potential cash inflows and outflows over a three-month period is compared to the liquidity stock. This liquidity stock comprises all assets that can be liquidated at very short notice. The difference of both figures (in absolute terms) indicates excess liquidity, once all claims assumed in the run-off profile have been fulfilled through the liquidity stock. There were no liquidity shortages throughout the period under review.

### Stress testing

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the Bank's liquidity situation. The various standardised scenarios used are evaluated on the basis of the liquidity run-off profile.

We generally consider the withdrawal of deposits from the housing industry as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

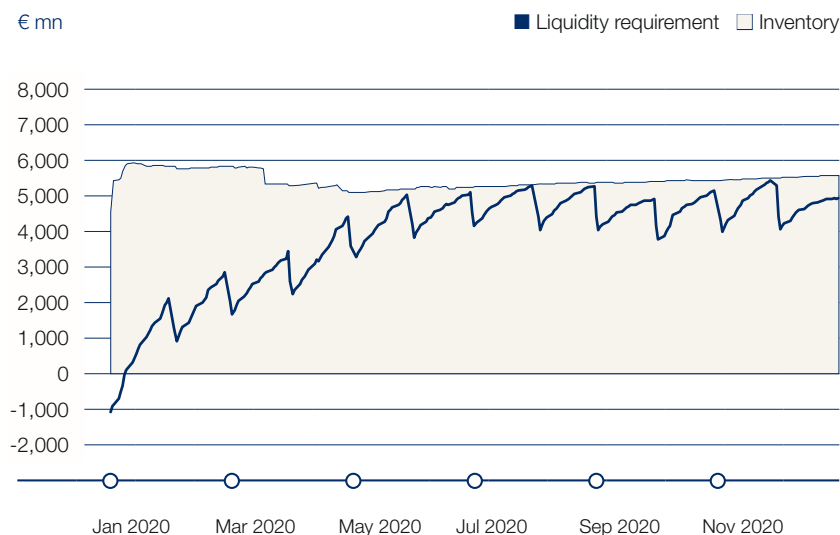
### Time to illiquidity

To safeguard adequate liquidity beyond the three-month horizon covered by the liquidity run-off profile, we use the concept of time to illiquidity as a parameter. For this purpose, a liquidity run-off profile was developed which compares liquidity requirements occurring with the liquidity stock, for a one-year period. Time to illiquidity (Ttl) denotes the remaining period (expressed in days) during which Aareal Bank Group can be regarded as sufficiently liquid, even under adverse conditions. In other words, liquidity requirements (including security add-on for adverse future events) do not exceed the liquidity stock.

The calculations are based on contractual cash flows and the short-term risk assessment methodology (liquidity run-off profile), as well as the portfolio development within the current plan scenario.

The following chart shows the projected development of the liquidity stock, together with aggregate liquidity requirements (incorporating planned portfolio developments, and including security add-ons for adverse future events) until the end of 2020. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions.

### Liquidity development



Further details are provided in the comments on the Bank's liquidity in the section on the "Financial position".

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### **Funding profile**

Diversifying the Bank's refinancing profile by type of investor, and by product, represents a further key aspect of our approach to liquidity risk management. Core sources of funding such as customer deposits and funds invested by institutional clients – alongside covered and uncovered bond issues – constitute the foundation of our liability profile. In this context, we refer to the comments regarding the breakdown of funding between money markets and capital markets, as set out in the description of financial position.

### **Concentration limits**

Besides the pure measurement of risk indicators, we also monitor concentrations of liquid assets and of funding sources, determining the percentage share of the ten largest counterparties and/or positions, relative to the total portfolio.

A limit is set for each indicator in order to restrict the dependency upon individual positions or counterparties.

### **LCR forecast**

We have developed the LCR forecast as a measurement tool designed to ensure that we maintain compliance with the regulatory Liquidity Coverage Ratio. A preview of the Liquidity Coverage Ratio is calculated over a horizon of up to three years, determining the ratio of highly liquid assets to cumulative net cash outflows for various end-of-month dates – thus identifying any potential liquidity shortfalls or reserves.

### **NSFR forecast**

The NSFR forecast, which is a projection of the Net Stable Funding Ratio over a period of up to three years, represents another important component of our liquidity management. This measurement tool allows us to forecast the regulatory Net Stable Funding Ratio for future dates, thus identifying any potential liquidity shortfalls or reserves in terms of the NSFR at an early stage.

## **Accounting-Related Internal Control and Risk Management System**

### **Tasks of the accounting-related Internal Control System (ICS) and the Risk Management System (RMS)**

The accounting-related Internal Control and Risk Management System includes principles, procedures and measures to ensure the effectiveness and the efficiency of internal and external accounting, in accordance with applicable legal provisions. The tasks of the accounting-related Internal Control System mainly include ensuring proper conduct of business activities, guaranteeing proper internal and external accounting, as well as ensuring compliance with relevant statutory and legal requirements applicable to the Company.

The objective of the accounting-related Risk Management System is to identify, assess and limit risks which may impede the compliance of the financial statements with applicable rules and regulations. As with any other Internal Control System, the accounting-related ICS and RMS may only provide reasonable – but not absolute – assurance with regard to achieving this objective, regardless of how much care is used to design and operate this system.

### **Organisation of the accounting-related ICS and RMS**

The Internal Control System of Aareal Bank takes into account the principles established by the Minimum Requirements for Risk Management (MaRisk) related to the company-specific design of the ICS. The design of this Internal Control System comprises organisational and technical measures to control and monitor the Company's activities, covering all entities of Aareal Bank Group. The Management Board of Aareal Bank AG is responsible for designing, implementing, applying, further developing and reviewing an appropriate accounting-related Internal Control System. The Management Board makes decisions as regards the scope and the design of specific requirements; it has

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defined the responsibilities for the individual process steps in connection with accounting by means of organisational guidelines, and has delegated these responsibilities to individual organisational units.

Aareal Bank prepares its financial statements in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB) and its consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as applicable in the European Union. The Finance & Controlling division controls accounting processes and is responsible for ensuring conformity with legal requirements, as well as with any further internal and external provisions. The accounting-related requirements that have to be applied are documented in guidelines. Furthermore, the Finance & Controlling division is responsible for developing IT guidelines.

During the period under review, Aareal Bank fully migrated large parts of its core banking system, including the general ledger and sub-ledgers for loans, investments, creditors and debtors to SAP S/4 HANA, the latest SAP software version. In addition to enhanced processing speed, the Bank thus benefits from innovative functions, and from simpler and more efficient systems maintenance.

For the consolidated financial statements in accordance with IFRSs, the companies that form part of the Group create an IFRS package as at the respective reporting date. This includes financial statements prepared under IFRSs and in accordance with the IFRS Group Accounting Manual, as well as the Notes and consolidation information (intercompany balances). All packages are recorded by the Finance & Controlling division in consolidation software and aggregated for the purpose of preparing the consolidated financial statements.

The Supervisory Board is responsible for monitoring the Management Board. Within the scope of financial reporting, it approves the single-entity financial statements of Aareal Bank AG as well as the consolidated financial statements and group management report. Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Audit Committee, which is primarily responsible for financial reporting issues and monitors the effectiveness of Aareal Bank's Internal Control System. It analyses and assesses the presented financial statements and internal risk reports as well as the annual report submitted by Internal Audit. In addition, the Audit Committee is responsible for determining the focal points of the audit, as well as for evaluating the auditors' findings. The Audit Committee includes an expert in the fields of accounting or auditing, pursuant to section 100 (5) of the German Public Limited Companies Act (Aktiengesetz – "AktG").

Internal Audit also assumes a monitoring function not related to the process. It reports directly to the Management Board, and provides auditing and consulting services which are designed to optimise Aareal Bank's business processes with regard to accuracy, safety and efficiency. The Internal Audit division supports the Management Board by evaluating the effectiveness and appropriateness of the process-dependent Internal Control System and of the Risk Management System in general. Any detected weaknesses regarding the identification, evaluation and reduction of risks are reported and addressed within the context of specific action plans.

Internal Audit also performs Group audit functions for Aareal Bank's subsidiaries, within the context of the Group's risk management. The review of the risk management's effectiveness and appropriateness covers the risk management and risk control systems, reporting, information systems, and the accounting process. To perform its tasks, Internal Audit has full and unrestricted information rights with respect to activities, processes and IT systems of Aareal Bank AG and its subsidiaries. Internal Audit is informed on a regular basis about material changes related to the Internal Control and Risk Management System.

The review of process-integrated controls conducted by Internal Audit is based on a set of internal regulations, procedural instructions and guidelines of Aareal Bank Group. The audit activities of Internal Audit comprise all of the Group's operational and business processes, and are carried out using a risk-based approach.

### **Components of the accounting-related ICS and RMS**

Within Aareal Bank, various measures related to the Bank's organisational structures and procedures help to fulfil the monitoring duties within the framework of its Internal Control System.



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A prerequisite for the monitoring system to work efficiently is a Written Set of Procedural Rules governing the distribution of tasks between the individual divisions and the scope of the respective activities. The organisational structure of the Finance & Controlling division is set out in the Bank's organisational guidelines. Aareal Bank's accounting system is structured observing the principle of separation of functions, which makes for a split between operative and administrative roles, and is designed to ensure a sufficient level of control.

Various guidelines exist for activities and processes. These guidelines are set out in the Written Set of Procedural Rules of Aareal Bank and available for inspection to all employees. There are requirements as regards data entry and control – as well as data storage – which have to be observed in general by all of the Bank's posting units. If necessary, results are reconciled across divisions or companies. Uniform accounting methods and measurement techniques are guaranteed through guidelines applicable throughout the Group. The requirements of these Group-wide guidelines substantiate legal provisions, and are adjusted on an ongoing basis to take current standards into account. The valuation techniques used, as well as the underlying parameters, are controlled regularly, and adjusted if necessary.

In addition, the Bank's Risk Manual summarises the material elements of Aareal Bank Group's Risk Management System. Specifically, the Manual describes the organisational workflows as well as methods and instruments used in the context of risk management. In this context, reference is made to our explanations in the Risk Report.

Clearly-defined rules as regards delegation of authorities facilitating the allocation of professional responsibilities also contribute to reliable financial reporting. Any decisions taken are always based on relevant authorities. Internal controls defined on the basis of risk considerations are embedded in the accounting process. Compliance with the principle of dual control in all material processes is one of the principles for ensuring accurate accounting. Where no integrated approval system/dual control feature has been implemented in the accounting IT systems for material transactions, this has been integrated and documented in the manual process workflows.

Adherence of accounting to generally accepted accounting principles is ensured by both preventive and detective controls, as well as through a review of processed data. The preparation of the consolidated financial statements is characterised by multiple analyses and plausibility checks. Besides the evaluation of individual accounting issues, these include comparisons of periods, and between plan and actual data. Control processes have been implemented for both manual and automated accounting transactions.

In order to increase the level of control quality, all relevant divisions are involved in the reconciliation process. An example of cross-divisional reconciliation is the process for the preparation of annual and interim reports. All divisions involved must ensure and (prior to preparation by the Management Board) confirm the quality of the sections of the reports they are responsible for. This represents an additional control level for the data to be disclosed.

In terms of organisational workflows, the accounting-related Internal Control and Risk Management System is based on a comprehensive standardisation of processes and software. Aareal Bank Group uses both standard and customised software. The consolidation software provides technical support to the reconciliation of Group-internal relationships, in a clearly-defined process. The data of the units included is reported using a uniform standardised chart of accounts. The Group's accounting-related IT systems were designed in such a way that both manual controls and automatic plausibility checks are performed for material technical and procedural system steps of the applications used. The controls in relation to processing within the IT systems are also integrated in the processes, as well as being independently performed. Process-integrated controls comprise, for example, the review of error and exception reports or the regular analysis of internal service quality. In contrast, Internal Audit conducts IT reviews independently from processes.

Data and IT systems must be protected from unauthorised access. A differentiated access authorisation concept is in place for the systems used for finance and accounting, preventing manipulation of data. Authorisations are allocated to the responsible employees, reviewed regularly, and adjusted if necessary in accordance with internal criteria.

Aareal Bank reviews its accounting-related Internal Control and Risk Management System on an ongoing basis. Necessary adjustments are made with respect to the accounting process based on the Bank's reviews. Adjustments may have to be made, for example, in connection with changes in the Group structure, to the business model, or new legal requirements.

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Aareal Bank has to comply with legal requirements. If these requirements change, for example in the form of new laws or changes in accounting standards, the processes or IT systems will be adjusted as required in separate projects across divisions – based on a clearly-defined allocation of functions, and the accounting-related Risk Management System will be adjusted to take the amended rules into account. Current developments of statutory and legal provisions applicable for Aareal Bank are constantly monitored and reported, not only by the responsible division, but also by a steering committee established by the Bank. This committee also initiates any required adjustments to be made to systems and processes, and reports the results to the Management Board.

## **Report on Expected Developments and Opportunities**

### **Macro-economic environment**

Developments for the economy, as well as for financial and capital markets, are exposed to diverse major risks and threats - which also have an impact on the commercial property markets. The economic forecast is defined by significant uncertainty. The key factors in this regard relate to geopolitical risks, protectionist economic policy and a less dynamic economy.

Sudden or excessive changes in interest rates may trigger revaluations and changes in investor behaviour, potentially leading to a decline in asset prices arising from a change in capital allocation. Emerging economies in particular will have to face capital outflows, and may have to raise their own interest rates. The economies were rendered vulnerable due to the protracted period of low interest rates caused by a lack of effort to reform and consolidate and increased levels of private debt. On the other hand, a longer-lasting period of low interest rates complicates an exit from such an environment, heightening the risks for the financial and capital markets. In this context, traditional central bank policy may lose its impact.

Protectionist measures, particularly those adopted by the US, pose a threat to both economic performance and the financial markets. An open trade war cannot currently be ruled out this year (it has already started in part), which, in addition to the reduction in trade in goods and services, could also cause turbulence on the financial markets.

Geopolitical conflicts can also cause shock jumps, in for example the price of oil, which can lead to a recession in less robust economic conditions.

The rapid spread of the coronavirus at the beginning of 2020 might have a negative impact upon many economies, and thus on the development of Aareal Bank Group's business and profitability for the full year, and perhaps beyond.

However, the political shift away from European cohesion not only represents the greatest threat for the EU but for Europe too. This is substantiated by Brexit, regional pro-secession efforts for example in Catalonia, and in particular by nationally focused governments in Central and Eastern Europe. This could also have a negative impact on the economy.

Higher and, in parts, continuing high levels of indebtedness in combination with a lack of reform efforts pose further risks in many countries and regions. In this context, changes in monetary policy may have a negative impact upon market confidence, triggering crises. Furthermore, private debt has risen considerably, especially in the emerging markets, and could lead to market corrections and systemic crises.

### **Economy**

Global economic growth in 2020 is expected to be lower than in 2019. However, the weak economic phase from the second half of 2019 is expected to persist until mid-year 2020. The second half of the year will likely benefit from an expansionary monetary and financial policy. Survey-based indicators currently suggest that the economic weakness should bottom out in 2020. In view of the information to hand, a recession in 2020 is not predicted up to now, even though it cannot be ruled out entirely.

We expect real gross domestic product in the euro zone to grow by around 0.8% in 2020. This is 0.4 percentage points lower than in 2019, which we view as being a noticeable decline. This is

implied by survey-based indicators and expectations of lagging effects, for example on the labour market, but the global effects of the coronavirus are also expected to have a negative impact.

We expect an economic growth of 1.0% in the UK for the current year. Supported by fiscal and monetary policy, quarter-on-quarter growth in the current year should improve gradually. However, the unregulated relationship with the EU will inhibit further positive developments. Of importance here is whether the prospect of a trade agreement with the EU at the end of the year or unregulated trade relations for the end of the transition phases will be the most likely development.

Real economic growth of 1.6% is expected in the US in 2020. Consumer spending will support growth, with the contribution made by investments and trading playing a somewhat lesser role. Economic growth of 1.2% for the current year is expected in Canada.

In China, we expect economic growth of 5.4% in the current year, negatively impacted by the coronavirus pandemic. The risks arising from the trade conflict with the US are likely to ease, which should stabilise growth. However, the high levels of private debt carried by the companies represents a risk for future economic development. In addition, the coronavirus pandemic may further dampen growth.

Real economic growth of 1.9% is expected in Australia in 2020. Growth in 2020 is burdened by lower commodity prices, slower credit growth and lower expectations of tourism due to the long-lasting bush fires.

### **Financial and capital markets, monetary policy and inflation**

These risks and uncertainties listed above are also impacting on financial markets in the current year. Were they to materialise to a significant extent, they might cause turbulence on capital markets as well. Under these conditions, volatility is expected to be higher overall than the year before. We continue to believe that the financial markets will remain receptive towards refinancing and new securities issues.

With the relaunch of its asset purchase programme, the ECB will remain on an expansionary path. Even the change at the head of the ECB will not lead to any fundamental changes. In the US, the Fed could respond to low inflation and economic growth below the previous year's level by cutting the key interest rate once more. In the UK, the Bank of England has tied its monetary policy orientation to the effects of Brexit. As the uncertainties persist, further interest rate increases are not expected in 2020.

Changes to monetary policy and economic weakness would tend to lead to a decline in long and short-term interest rates. However, as the central bank measures will be less powerful than in the past, long and short-term interest rates are likely to remain stable in 2020. On the other hand, short-term interest rate in the US are likely to be lower at the end of the year, as the FED's purchase programme is aimed more at the short-term interest rate corridor.

Inflation could rise overall by a few basis points in 2020, not least due to higher energy prices. Geopolitical risks, e.g. in Iran, can impact on oil prices and hence on inflation to a certain extent. Lower economic momentum is likely to cap the increase in the relevant currency areas.

### **Regulatory environment**

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (a concept known as "Basel IV").

The new requirements of CRR II, CRD V and BRRD II were also finalised and still have to be transposed into national law, where relevant. In addition, EBA has passed guidelines on PD and LGD estimates, the treatment of risk exposures, and the determination of downturn LGDs – which will need to be implemented.

The EBA guidelines on granting and monitoring loans will place further demands on the banks' internal governance (incl. in risk culture and strategy) and on the credit processes (incl. documentation, credit rating review) as well as the monitoring framework (e.g. monitoring the credit terms).

The requirements are supplemented at a European level by another MaRisk amendment at national level, which is awaiting consultation in 2020.

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Furthermore, supervisory authorities are increasingly focusing on the topic of sustainable finance – not least due to BaFin's Guidance Notice on Dealing with Sustainability Risks.

To facilitate the timely implementation, we have already continued to pursue the individual issues in numerous projects, devoting considerable resources to this task.

The volatility of requirements presents an additional challenge for institutions: besides the new requirements mentioned by way of example, this volatility is particularly a function of the concrete specifications for instruments implemented by the ECB and/or the national supervisory authorities. For instance, the capital buffers to be set on a national level (the anticyclical buffer and the buffer for systemic risks), or the annual results of the Supervisory Review and Evaluation Process (SREP) for individual banks, can only be planned to a certain extent. Moreover, these instruments may lead to changes in a bank's individual capital requirements, at short notice.

## **Sector-specific and business developments**

### **Structured Property Financing segment**

Demand for commercial properties will vary in 2020, depending on the region and property type. A shortage of top-class properties, along with reticence among different investors to invest in specific markets (such as the UK with a view to the trade relations that still exist with the EU) or in specific property types (such as retail, with regard to the changes brought about by online trading, among other things), will make itself felt in global transaction volumes. These are unlikely to exceed the previous year's levels.

Commercial property markets, as well as the economy, are exposed to major risks and threats. Besides economic influences, individual shifts in the interest rate environment can have a negative impact on market values. Moreover, other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets.

Several factors will influence the market value of commercial property over the course of the year. While the economy and historically low interest rates are likely to support property values, political uncertainty, economic downturns or investor reticence can have an adverse effect on values. Despite the persistent economic cycle, the market cycle is still intact, therefore also potentially leading to cyclical downturns in the commercial property market.

Based on the conditions described above, we therefore anticipate a largely stable development<sup>1</sup> on average of  $\pm 2.5\%$  in the market values of commercial property in many markets this year.

We expect a stable development of market values of  $\pm 2.5\%$  in 2020 in most European countries, such as Finland, France, Germany, the Netherlands, Poland, Russia and Sweden. For Spain, on the other hand, we consider positive growth 2.5% to be possible. Uncertainties persist in the UK due to the as yet unresolved issue surrounding the contractual relations with the EU at the end of the transition period. An exit with a quick solution should have a positive effect on market values, while a protracted and unclear process would likely drive down market values by more than 2.5%. Political uncertainty in Italy could have a negative impact on property values. Despite the stable development overall, we could see declining values in some European sub-markets or for some property types.

We assume property values in the US will remain stable at  $\pm 2.5\%$  on the whole. A stable performance of  $\pm 2.5\%$  in 2020 also looks likely for Canada in 2020.

In Australia and China, stable market values of  $\pm 2.5\%$  on average for commercial property are expected.

These developments should also tend to apply to office and logistics properties. The performance of retail property on average could be negative overall.

As was the case last year, the European hotel markets are for the most part expected to report positive growth in average revenues per available room. Occupancy rates in most markets are expected to be higher, historically.

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<sup>1</sup> The performances of individual property types or of individual markets and sub-markets may deviate from the expectations referred to above.

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Some market participants expect a less dynamic economy to lead to stagnating (or falling less than 1%) occupancy rates and average room rates on the US hotel market. In Canada, the stable development of average revenue per available room is likely to continue. As we see it, the risk of a decline is a more likely prospect than an increase due to lower year-on-year economic growth. The increase in the number of rooms available should also lead to a further decline in the occupancy rate.

For the Asia/Pacific region, we anticipate occupancy ratios and average revenues per available room for 2020 as a whole to remain in line with the previous year in the hotel markets of many metropolitan areas.

The competition for commercial property financing, which is described as intense, is likely to persist on many markets this year, whereby we consider the readiness of lenders to reduce their margins as a given, even though a plateau might be about to emerge, particularly in Europe. Banks are expected to continue adhering to their preference for financing first-class properties in prime locations with stable loan-to-value ratios.

We have incorporated various market aspects and our business strategy, which are reflected in the motto of "Aareal Next Level", in our assessment of anticipated new business volumes for the current year. For the Structured Property Financing segment, we are targeting new business of between € 7 billion and € 8 billion for the 2020 financial year, whereby the focus is set to remain on the higher-margin US market and Western Europe. Aareal Bank Group's property financing portfolio should amount to between € 26 billion and € 28 billion at the end of 2020, subject to currency fluctuations. To manage our portfolio and risk exposure, we also use syndications which facilitate larger-sized financing solutions.

The forecasts are based on the assumption that the macro-economic risks and uncertainty factors described above will not materialise to a significant extent, or only in a manageable manner: otherwise, they might influence business development, for example, in terms of new business.

## **Consulting/Services segment**

### **Bank division Housing Industry**

The German housing and commercial property industries are expected to continue showing solid development in 2020, on the back of rising rental income and a high degree of stability in property values.

The companies will continue to optimise and develop existing portfolios, driven especially by political and socio-political aspects, such as refurbishing buildings to make them suitable for the elderly, district development or the significantly underdeveloped urban centres. The demands of climate protection targets for Germany and the decisive bearing on the property industry to achieve them is putting serious demands on resources. The fact that the necessary investments are not economically feasible is posing a problem and will lead to political tension in the years ahead. Political decisions and their impact on the profitability of the measures, as well as greater expectations of the energy retrofitting ability and increasing regulatory requirements may be affecting future corporate investment activities.

The stable development on the residential property market is expected to prevail in 2020. Regional differences are likely to increase further. Due to the ongoing urbanisation trend, we expect demand for apartments to rise further, especially in economically strong conurbations. Property investors and potential sellers within the housing and commercial property industries should continue to benefit from these market developments.

We see good opportunities during 2020 to acquire new clients and to intensify the business relationships with our existing client base. This also applies to utilities and the waste disposal industry. In addition, in line with our strategic orientation, we continue to invest in the expansion of the "Housing Industry Ecosystem", the cross-sector development of interface products, and the expansion to adjacent ecosystems. The focus here is on, for example, the functional expansion of the Aareal Portal corporate client platform as regards the digitalisation of client communication and account processing.

In our view, the range of services that connect alternative online payment solutions to existing systems, thus helping to overcome process breaks (even across industry sectors), are particularly interesting. The Aareal Exchange & Payment Platform, which integrates alternative payment processes in existing accounting systems should be market ready in 2020. We also see potential in technical solutions for automating billing processes as part of electromobility in the network of charging stations. A corresponding product was also tested already in 2019.

Besides these future technologies, we also see growth in established processes and procedures, such as incorporating the offers of plusForta GmbH, which was acquired in the financial year, in deposit management.

Against this background, we are aiming for net commission income growth of 15% year-on-year (2019: € 23 million), expecting an average deposit volume from the housing industry of € 10 billion to € 11 billion. The persistently low interest rate environment, which is relevant for the results from our deposit-taking business, will continue to burden segment results. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important additional source of funding for Aareal Bank.

### **Aareon**

Aareon will continue in 2020 to pursue the growth strategy based on its strategy programme integrated in Aareal Bank's strategic orientation. Overall, sales revenue is expected to rise significantly.

Aareon expects a slight increase in sales revenue in the ERP business, anticipating new customer gains and an increasing business volume with existing clients to contribute. Various customer projects will be rolled out in 2020, thus generating higher revenues from maintenance and SaaS. Overall, a shift from licence revenues to recurring revenues continues to be expected, due to the increased conclusion of maintenance and SaaS contracts. The new cloud-based Tobias 365 ERP product generation in the Netherlands will lead to a decline in the revenues to be realised with this product, as migrations from the formerly in-house to the cloud solution will result in a shift in revenues to the future. This effect will be felt especially in 2020 and 2021, but will lead to higher revenues in the future. The migration business in Germany will ease slightly and the business with existing clients will continuously be driven forward. As at 31 December 2020, most clients using the GES product will have migrated to Wodis Sigma or SAP® solutions and BlueEagle. Sales revenue in the energy utility market is expected to rise sharply. Developing further capacity should allow more projects to be implemented. Marked increases are also expected in the commercial property market. Additional customer acquisition is expected in the DACH region with the RELion products and in the Netherlands with REMS.

The digital solutions are the main drivers of organic sales growth in Aareon. Besides the organic sales growth through further market penetration with existing and new solutions, the acquisition of the CalCon Group as at 1 January 2020 will lead to a significant increase in digital solutions revenue. Furthermore, Aareon plans to make further significant investments in expanding its range of digital solutions related to new technologies, and to participate in the start-up scene, to accelerate organic growth. Aareon expects the first sales revenues from these measures in 2020. The CRM (customer relationship management) and WRM (workplace relationship management) products from the existing portfolios will contribute primarily to these. There is still very strong demand among clients to digitalise their processes.

Based on the explanations outlined above, Aareon envisages a marked overall increase in sales revenue to between € 272 million and € 276 million (2018: € 252 million). The company estimates an adjusted EBITDA<sup>1</sup> in a range of 68 million to € 71 million (2018: € 64 million). We have adjusted the performance indicator in line with a standard target figure often applied to software companies within the scope of developing a value proposition independently of Aareal Bank.

### **Business strategy**

Aareal Bank Group's strategy focuses on sustainable business success. In an environment characterised by technological change, further growing regulatory requirements, altered client needs and fiercer competition, its aim is to secure the foundation while also leveraging new revenue potential. Following on from the "Aareal 2020" programme for the future, the medium-term strategic development process will continue under the motto of "Aareal Next Level". The general strategic orientation will continue – with large-volume, international commercial property financing on the one hand and consulting and services for the housing sector in Europe and related industries on the other. The individual business activities will be developed in a targeted manner, in order to sharpen their own independent profiles, accelerate the Group's growth overall and create value for the shareholders and other stakeholders.

<sup>1</sup> "Earnings before interest, taxes, depreciation and amortisation" Excluding strategic investments and non-recurring effects

The emphasis in the Structured Property Financing segment is to ensure the Bank's success of previous years and secure its existing position in an adverse environment. To do so, Aareal Bank makes systematic use of the flexibility gained in recent years regarding regions, asset classes, structures, and exit channels, as well as expanding the activities along the value creation chain. In the existing Consulting/Services segment, both areas – the banking business and Aareon – will continue to grow in the years ahead. The objective is to gradually reduce the overlaps and cross-dependencies, while strengthening the independence of the individual brands and business models – whilst securing existing synergies at the same time.

### Company and Group targets

Key targets of Aareal Bank AG are the preservation of capital and the ability to distribute dividends. These are being taken into account for Group planning purposes, and are also set to be achieved in 2020. No single-entity planning is prepared for Aareal Bank AG. Accordingly, the following statements refer to Group planning in accordance with IFRSs.

### Group targets

Aareal Bank Group believes the market and competitive environment will remain challenging in the current year. It also expects ongoing political and economic uncertainties. No relief is to be expected either from regulatory pressures or from the low interest rate environment. As a result of the spread of the coronavirus and the efforts to combat it, considerable volatility and serious implications can currently be observed on the capital markets, but also in the overall economic environment. At present, it is impossible to assess to what extent these may influence the business and earnings development, hence they are not included in the forecasts.

We will – as stated in “Aareal Next Level” – introduce measures in the current year to stabilise and optimise the existing business, and will expedite investments in new products and in future growth.

We anticipate a slightly lower net interest income, compensated by a higher contribution from Aareon to net commission income, and thus overall stable net interest and net commission income (2019: € 762 million). Loss allowance is expected to decline to a risk cost level of just under 30 basis points (in terms of the property financing portfolio), and thus below the figure for 2019 (€ 90 million). Administrative expenses are expected to rise slightly year-on-year (2019: € 488 million), whereby the effects from Aareon's business growth are likely to more than offset lower expenses incurred by the Bank.

For the current year, we expect consolidated operating profit and a return on equity (before taxes) at similar levels compared to 2019 (€ 248 million and 8.7%, respectively). The forecasts for loss allowance and operating profit do not include any effects from a potential, selective continuation of accelerated de-risking activities. Consolidated net income allocated to ordinary shareholders of Aareal Bank and earnings per share (EpS) are anticipated to be stable compared to the previous year's figures of € 145 million and € 2.42 – even considering possibly accelerated de-risking.

Assuming a more positive environment, the initiatives undertaken in the context of “Aareal Next Level” will permit to achieve RoE before taxes of around 12% over the medium term.

As in the previous year, new business volume for the current year is expected to range between € 7 billion and € 8 billion. Subject to exchange rate fluctuations and market conditions permitting, the property financing portfolio will continue to remain in a range between € 26 billion and € 28 billion.

We are aiming for net commission income growth of 15% year-on-year (2019: € 23 million) in the Bank's Housing Industry division segment, expecting an average deposit volume from the housing industry of € 10 billion to € 11 billion.

Aareon, which will henceforth be shown as a separate segment, is projected to increase sales revenues by low double-digit growth rates, to between € 272 million and € 276 million (2019: € 252 million), with adjusted EBITDA<sup>1</sup> set to rise to between € 68 million and € 71 million (2019: € 64 million).

Subject to further regulatory changes, Aareal Bank considers a target CET1 ratio (post-finalisation of Basel III – so-called “Basel IV”) of around 12.5% fully phased to be appropriate. The CET1 ratio is expected to slightly exceed the target ratio by the end of the year.

<sup>1</sup> “Earnings before interest, taxes, depreciation and amortisation” Excluding strategic investments and non-recurring effects

## Remuneration Report

Remuneration is a key element of managing the business, and of managing risk. The remuneration strategy at Aareal Bank Group forms part of the Company's efforts to ensure that employees' remuneration is in line with market conditions and the performance achieved. At the same time, it helps to align the Group's remuneration intentions with current regulatory requirements. When setting remuneration, Aareal Bank Group therefore pays attention to ensuring that the proposed remuneration motivates employees to achieve the Group's strategic business and earnings targets whilst remaining within the boundaries set by the Group's risk appetite and corporate values. Whilst good performance is remunerated accordingly (through a bonus), any breaches of internal or external rules are penalised through sanctions (penalties).

The Chairman of the Supervisory Board and Aareal Bank AG's shareholders discuss remuneration transparency and the remuneration system on a regular basis. To increase the transparency, the Remuneration Report was revised. The Supervisory Board will continue to address potential adjustments to the remuneration system for the Management Board and related reporting, discussing it with major stakeholders.

### Remuneration system for the Management Board

#### Overview

The Supervisory Board of Aareal Bank designs a remuneration system which provides incentives to Management Board members for achieving the Bank's strategic goals and targets, within the framework of the defined risk appetite, risk strategies and in line with the corporate and risk culture, and the values determined in the Code of Conduct. As a 'significant institution' which is subject to direct supervision by the European Central Bank, Aareal Bank's scope in setting remuneration is subject to tight restrictions, pursuant to the specific regulatory requirements for banks, pursuant to the EU Capital Requirements Regulation (2013/575/EU), the German Banking Act (Kreditwesengesetz – KWG), and the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – InstVergV).

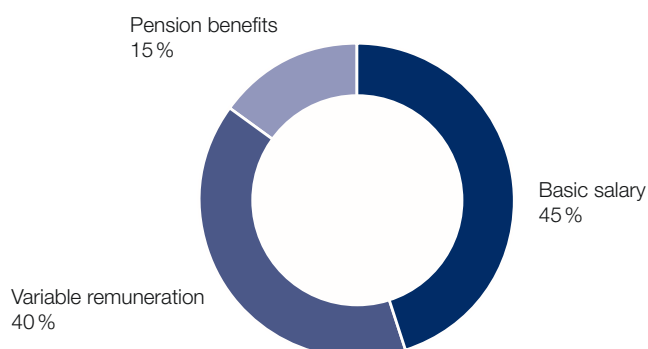
#### Remuneration structure

Total target remuneration comprises a fixed component (including ancillary benefits and contributions to retirement provisions) and a variable component, the structure of which is governed by law.

The diagram below illustrates the ratio between the fixed and variable components of the remuneration of all members of the Management Board since reporting year 2019:

#### Management Board remuneration structure

%





Remuneration element	Description	Reference to strategy and long-term development
<b>Fixed remuneration elements</b>		
Fixed annual salary	<ul style="list-style-type: none"> <li>Fixed contractually agreed remuneration, paid monthly in the amount of 45% of the target total remuneration of the Management Board members</li> <li>Chairman of the Management Board: € 1,425,000</li> <li>Ordinary Management Board members € 900,000</li> <li>Members of the Management Board for whom the so-called “newcomer rule” applies: 80% of an ordinary Management Board member’s fixed annual salary</li> </ul>	Guaranteeing the fixed income in the form of a fixed annual salary and ancillary benefits equivalent to scope and complexity of the business and the role and responsibility of the individual members of the Management Board, and competitive on the market.
Ancillary benefits	<ul style="list-style-type: none"> <li>Company car, which may also be used for private purposes or a flat rate payment if a company car is not opted for</li> <li>Group accident insurance</li> <li>Specific costs for security measures</li> </ul>	
Pension obligations	<ul style="list-style-type: none"> <li>Defined contribution commitment</li> <li>Annual contributions of 15% of overall target remuneration of the Management Board members</li> <li>Members of the Management Board who were appointed prior to 1 January 2013 entitled to claim pension benefits as of the time at which they turn 60</li> <li>For members of the Management Board who were appointed after 1 January 2013: entitled to claim pension benefits as of the time at which they turn 62</li> <li>In the event of permanent disability, a Management Board member is entitled to claim benefits prior to turning 60 or 62, respectively</li> </ul>	
<b>Variable remuneration elements</b>		
	<ul style="list-style-type: none"> <li>40% of the Management Board members’ total target remuneration</li> <li>The reference value for 100% target achievement amounts to € 1,250,000 for the CEO, and to € 780,000 for ordinary Management Board members</li> <li>Variable remuneration is determined via the achievement of targets strictly derived from the business and risk strategies, and which are in line with Aareal Bank’s corporate and risk culture</li> <li>Group (70%), sectional (15%) and individual (15%) targets</li> <li>Performance measurement based on criteria whose performance is determined over a retrospective three-year period</li> <li>No discretionary components besides the targets derived from the strategy</li> <li>Breakdown of variable remuneration via four components (as per regulatory requirements)</li> <li>80% of the variable remuneration is paid out on a deferred basis</li> <li>Maximum overall target achievement level is capped at 150% of the target value</li> <li>Maximum variable remuneration cannot exceed fixed remuneration</li> </ul>	<p>Provision of a variable remuneration on the basis of annual financial and non-financial performance criteria that are relevant for Aareal Bank’s strategy.</p> <p>Provides incentives to Management Board members for implementing the business priorities of Aareal Bank and to act in the interest of the long-term and sustainable positive business development.</p> <p>Group performance targets account for 70% of overall target achievement, hence prioritising the entire Company’s interest, including shareholder expectations.</p> <p>By granting the variable remuneration, Aareal Bank meets the regulatory requirements to which it is subject.</p>

Remuneration element	Description	Reference to strategy and long-term development
<b>Other rules</b>		
Risk-bearing capacity	Before disbursing the variable remuneration, the Supervisory Board reviews it regarding its compatibility with the risk-bearing capacity.	Disbursing variable remuneration is not meant to threaten Aareal Bank's financial solidity.
Penalty and clawback	<ul style="list-style-type: none"> <li>All components of the variable remuneration are subject to penalty and clawback provisions.</li> <li>Admission of an adjustment to outstanding remuneration and/or clawback of remuneration already disbursed in case of clawback events.</li> </ul>	Within the meaning of responsible and sustainable corporate governance, and for the purpose of implementing the regulatory requirements, penalty and clawback rules are a mandatory part of good corporate governance, which in turn is firmly enshrined in Aareal Bank's strategy.

The amount of variable remuneration is based on previously agreed targets. The assessment period for target achievement must be at least three years long, adding a five-year deferral period for at least 60% of variable remuneration, and – pursuant to section 20 (5) of the InstitutsVergV – 50% of variable remuneration shall be disbursed into financial instruments used by companies, i.e., especially shares or share-based instruments to be held for a minimum period of one year. Aareal Bank uses virtual shares as such an instrument. This way, members of the Management Board participate in the Bank's development for up to six years. Performance of virtual shares is capped at 300%.

Due to the target determination period of at least three years, all Aareal Bank's remuneration targets qualify as long-term incentives (LTIs). 50% of the entire variable remuneration is paid in form of share-based instruments.

Aareal Bank cannot merely provision for a holding period for shares after the targets have been achieved – as the German Corporate Governance Code for instance recommends. Regulatory requirements mandate that 60% of variable remuneration is retained. Taking the target determination period together with the deferral and holding periods, the actual amount of variable remuneration for a given financial year is determined over an aggregate period of nine years. Given this very long period, which is prescribed by regulations, the Supervisory Board has refrained from imposing any further conditions or disbursement modalities.

There is no need for an agreement requiring Management Board members to enter into any proprietary investments in Aareal Bank shares, since the Supervisory Board believes that the existing system meets the purpose of such an investment. By granting 50% of variable remuneration in the form of virtual shares, together with the fact that variable remuneration – assuming a target achievement level of 100% – is nearly equivalent to the fixed annual salary, Management Board members will have regularly earned virtual shares equivalent to a fixed annual salary level after three years. Given the long deferral periods and the holding periods, this is a value which they usually retain until the end of their term on the Management Board (cf. section "(Virtual) shareholdings of Management Board members and share-based remuneration (**share ownership**)").

Achievement of initial targets is regularly reviewed during the deferral period (**back-testing**), and the level of target achievement originally agreed upon and, as a result, the amount of the variable remuneration is adjusted ex-post if necessary. Variable remuneration for a given financial year may be reduced in the event of inappropriate behaviour, or behaviour in breach of duties – in other words especially due to wilful breaches of internal or external rules, including Aareal Bank Group's Code of Conduct and the values determined therein. In the case of negative performance contributions, as defined in detail by the Supervisory Board, in the form of significant losses or material regulatory sanctions, variable remuneration must be reduced to zero (**penalty review**). Where a portion of variable remuneration for such financial year has already been disbursed, this portion may be reclaimed on the basis of corresponding provisions in Management Board contracts (**clawback**). Variable remuneration will no longer be paid in the event of any threats to the Bank's risk-bearing capacity, sufficient capitalisation or liquidity, or if certain minimum profitability indicators are not achieved.

Pursuant to section 25a (5) of the German Banking Act (KWG), the variable remuneration must not exceed the fixed remuneration component for Management Board members, even in the event of maximum target achievement. The option of allowing the Annual General Meeting to approve higher variable remuneration corresponding to up to 200% of the fixed remuneration component, as set out in section 25a (5) sentence 5 KWG, has not been used for the Management Board members.

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The maximum overall target achievement level for determining performance-related, variable remuneration is additionally capped at 150%. Hence, variable remuneration determined cannot exceed 150% of the reference level.

### **Fixed remuneration component**

The fixed remuneration component of a Management Board member consists of three components – the fixed annual salary, ancillary benefits, and contributions to retirement provisions.

#### **Fixed annual salary**

Within Aareal Bank's corporate governance system, the members of the Bank's Management Board discharge operative functions in addition to their managerial duties. They prepare and implement strategic objectives in cooperation with their employees. Management Board members are remunerated in line with this comprehensive set of duties.

In order to prevent any motivation for Management Board members to enter into inappropriate risks, in accordance with Aareal Bank Group's risk culture, fixed remuneration accounts for a significant portion of the total remuneration package, which amounts to € 1,425,000 for the Chairman of the Management Board and to € 900,000 for ordinary Management Board members.

#### **Ancillary benefits**

Aareal Bank provides a company car to Management Board members, which may also be used for private purposes. Management Board members are covered by group accident insurance in case of death or invalidity. In addition, Aareal Bank AG bears the costs incurred for certain security expenses.

#### **Pensions and retirement benefits**

The benefit regulations as agreed in the service contract apply to the members of the Management Board. All members of the Management Board are granted a defined contribution commitment:

This amounts to € 464,000 p.a. for the Chairman of the Management Board, € 293,000 p.a. in general for ordinary members of the Management Board and thus accounts for 15% of the target remuneration structure of the Management Board members.

Management Board members who were appointed prior to 1 January 2013 are entitled to claim pension benefits as of the time at which they turn 60. For members of the Management Board who were appointed on or after 1 January 2013, claims arise as of the time at which they turn 62. In the event of permanent disability, a Management Board member is entitled to claim benefits prior to turning 60 or 62, respectively.

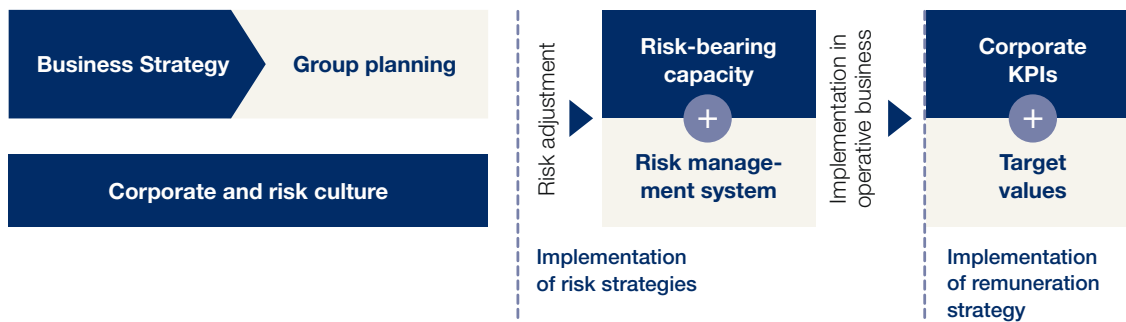
The amounts are subject to a guarantee adjustment of 1% p.a. The pension paid to widows amounts to 60% of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10% and not more than 25%, respectively.

### **Performance-related variable remuneration**

#### **Remuneration and target derivation system**

As a matter of principle, Aareal Bank derives remuneration targets from its strategic planning for the following years, which was already verified as to its compatibility with the corporate and risk culture, as well as with the Bank's risk strategies, and adjusted if necessary. Hence, the target parameters (KPIs) derived from the strategy are therefore geared towards the long-term and sustainable development of Aareal Bank Group – as opposed to short-term successes – and are thus aligned with the interests of shareholders, employees and other stakeholders.

## Derivation of remuneration strategy, indicators, and target values



### Remuneration parameters (ex-ante risk adjustment)

A significant part of Aareal Bank's variable remuneration is governed by law: besides the general requirement – pursuant to the German Public Limited Companies Act (Aktiengesetz – "AktG") – that the remuneration system be focused on a sustainable company development, sections 19 and 20 of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV") require that target achievement be determined on the basis of at least three target levels, and over a minimum assessment period of three years. Accordingly, Aareal Bank's remuneration system for the Management Board provides for three target levels of:

- ◆ Group performance;
- ◆ sectional performance; and
- ◆ individual performance.

Target achievement for each target level is determined on the basis of a three-year assessment period.

All targets for Management Board members are geared towards achieving the long-term and sustainable objectives set out in the Bank's business and risk strategies (**pay-for-performance principle**). To measure and monitor target achievement, KPIs are determined annually for the long-term and sustainable targets, and their degree of achievement is assessed at the end of the financial year. The target achievement level for each target level is thus determined by the respective KPI achievement of the past financial year and by the degrees of KPI achievement of the two previous financial years (**three-year assessment basis**).

When setting targets, the Supervisory Board pays attention to defining ambitious yet realistic targets, which are in line with Aareal Bank's risk appetite as well as the corporate and risk culture. The targets comprise quantitative and qualitative components, which are also related to non-financial parameters. Annual target achievement is reported on an ex-post basis (cf. Remuneration of the Management Board > Target achievement).

Amongst other things, the Company's interests are duly taken into account by the fact that **Group targets** are geared towards the KPIs used for corporate management purposes. Consolidated operating profit before taxes is generally chosen as an income target, whereas risk-weighted assets (RWAs) are used as a risk-adjusted target. Specific values are determined annually for both target components, which correspond to a 100 per cent target achievement. These targets at least complied with the corporate objectives communicated to the capital markets in the past, and will continue to do so in the future. The maximum achievement level for target consolidated operating profit is 150%; for the RWA target, it is 125%. The overall target achievement level is calculated by multiplying both target values; it is capped at a target achievement level of 150 %.

**Sectional targets** are related to the respective Management Board member's area of responsibility pursuant to the schedule of responsibilities. Accordingly, the Supervisory Board sets targets which the organisational units assigned to the respective Management Board members need to fulfil in order to achieve the strategic objectives of the Company as a whole. These targets may comprise

income and budget targets, target values for specific risk indicators, or for implementation of key strategic projects. In line with Aareal Bank Group's management system, sectional targets for Management Board members responsible for Sales units comprise growth enhancement and development of main strategic fields of business and are measured, for example, by the level of specific property portfolio increases or the revenue generated with digital products. In accordance with Aareal Bank Group's risk management system, these income parameters must not exceed the risk appetite as determined by reference to certain limits; hence, there is no incentive to enter into inappropriate risks. Sectional targets for Management Board members responsible for central staff functions or control units are based on other indicators, such as the amount of the administrative expenses. Moreover, within the framework of sectional targets, all members of the Management Board are required to fulfil specific projects in order to implement the Company's strategy – such as projects for the digitalisation of processes and products, and other targets described in the (Group) Management Report (cf. Report on Expected Developments and Opportunities, chapters Business strategy and Group targets).

**Individual targets** refer to the Management Board members' individual performance; in this respect, Management Board members are required in particular to exercise their function as role models vis-à-vis staff and the general public (*tone from the top*). They also need to achieve material sustainability aspects, including organisational and cultural measures, contributing to more cooperation and thus to Aareal Bank's efficiency.

The business and risk strategies reflect the sustainability approach pursued by Aareal Bank with specific measures which the Supervisory Board requires the Management Board to implement. Hence, sectional as well as individual targets also include **ESG targets** (environmental, social, governance), which includes taking ESG opportunities, managing and reporting on corresponding risks, and developing specific ESG criteria to be considered in the core business. In its targets, Aareal Bank does not separately reflect compliance with statutory regulations, since adherence to internal and external provisions is deemed to be a necessary condition for confidential cooperation; as such, separate target-setting within the scope of variable remuneration is obsolete. Wilful breaches of internal and external rules may rather trigger a so-called penalty-triggering event which in turn can lead to variable remuneration no longer being paid at all, or even to an ex-post reduction or claw-back of already granted deferred remuneration components.

#### **Performance measurement on individual target levels for the last financial year**

The members of the Management Board are responsible – and epitomise – the Company's success. This is also reflected in the **weighting of the target levels**. Accordingly, achieving Group performance targets accounts for the clear majority (70%) of target achievement. This target level is determined solely on a quantitative basis; performance is therefore calculated based on whether the target value specified by the Supervisory Board for the two components consolidated operating profit and risk-weighted assets has been achieved.

The other two target levels, the sectional and individual target levels, are weighted at 15% each. Three to four targets are determined per level. As previously described, they are mainly measured against qualitative KPIs, and additional quantitative KPIs only implemented for the Management Board member responsible for Sales units. When assessing the respective KPI, the Supervisory Board does not only simply evaluate whether the target has been achieved, but also whether the performance rendered is in line with the defined corporate and risk culture. In the event that this aspect has a positive or negative influence, the Supervisory Board would disclose it accordingly to the shareholders when talking about target achievement (cf. Remuneration of the Management Board > Target achievement). The following diagram gives a concise overview of performance measurement:

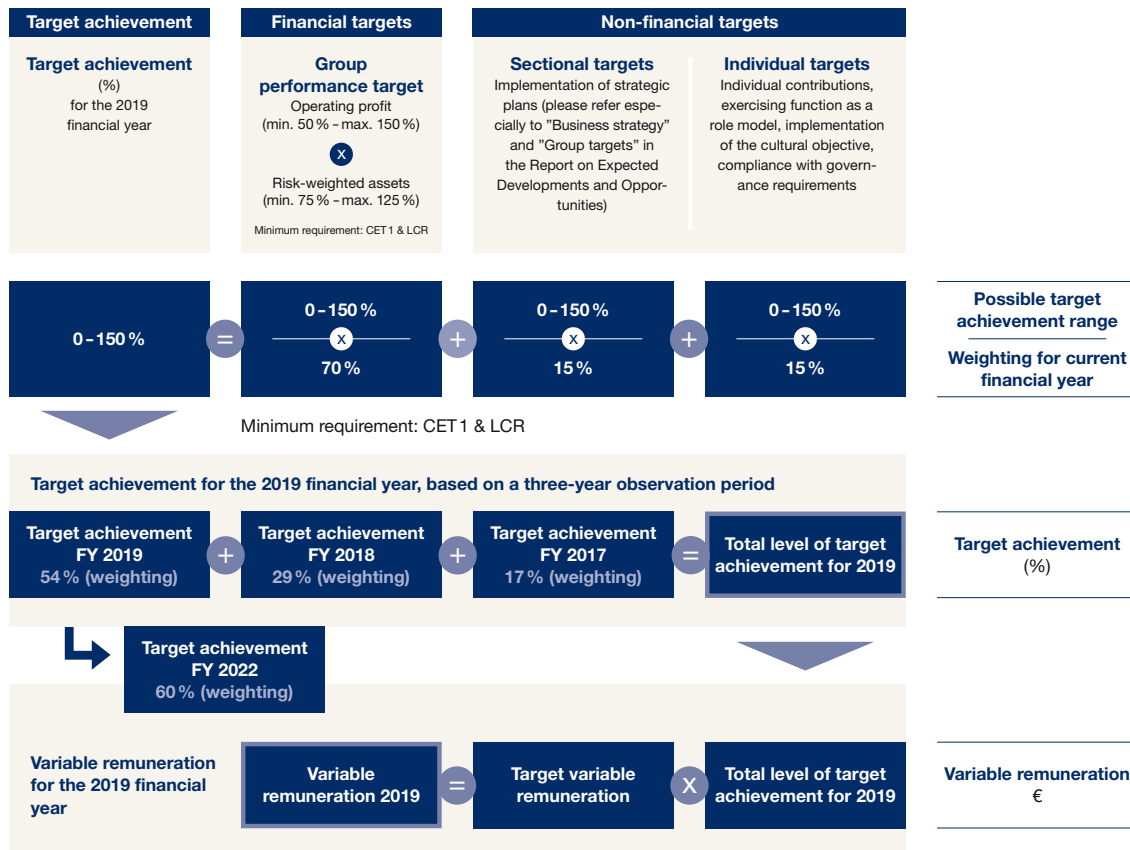
## Performance measurement on individual target levels

Target	KPI (FY)	Actual achievement	Assessment	Target achievement level (FY)
<b>Group performance target level</b>				
▶ Cons. operating profit before taxes	quantitative	X %		X %
▶ Risk-weighted assets	quantitative	X %		X %
<b>Divisional target level (exemplary)</b>				
▶ Growth target	quantitative	X %	Performance in line with the defined corporate and risk culture ☑	X %
▶ ESG target	qualitative	X %		
▶ Strategic project	qualitative	X %		
<b>Individual target (exemplary)</b>				
▶ ESG target	qualitative	X %	Performance in line with the defined corporate and risk culture ☑	X %
▶ Efficiency target	qualitative	X %		

### Overall target achievement (3-year measurement)

The principle of multiple-year assessment was applied only to the Group performance targets until 2018, and initially extended to remuneration determined at all target levels for the 2019 financial year. To set ambitious targets and a strong incentive for successful Management Board work, target achievement levels are incorporated at different levels over time. Following a transition period, the most recent reporting year will be weighted at 60%, the preceding one at 30%, and the oldest year in the assessment period at 10%. The transition phase ends with the variable remuneration for the 2021 financial year. With regard to the variable remuneration for the year under review, reporting year 2019 is weighted at 54%, financial year 2018 with 29% and financial year 2017 with 17%.

Target achievement and variable remuneration for the 2019 financial year under review



Deferred disbursement, through retention of variable remuneration components and virtual shares

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is awarded at the end of the financial year, according to the following principles:

- ◆ After confirmation of the total target achievement level by the Supervisory Board, 20% of the variable remuneration are disbursed in cash (**cash bonus**).
- ◆ After confirmation of the total target achievement level by the Supervisory Board, a further 20% of the variable remuneration is granted in the form of virtual shares (**share bonus with holding period**) and forms part of the share bonus plan.
- ◆ 30% of the variable remuneration is retained (**cash deferral**), and disbursed in cash – pro rata temporis – over a five-year deferral period.
- ◆ The remaining 30% of the variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the Share Deferral Plan (**share deferral with holding period**).

This means that deferred disbursement applies to 80% of variable remuneration determined, for up to six years.

Five-year retention period

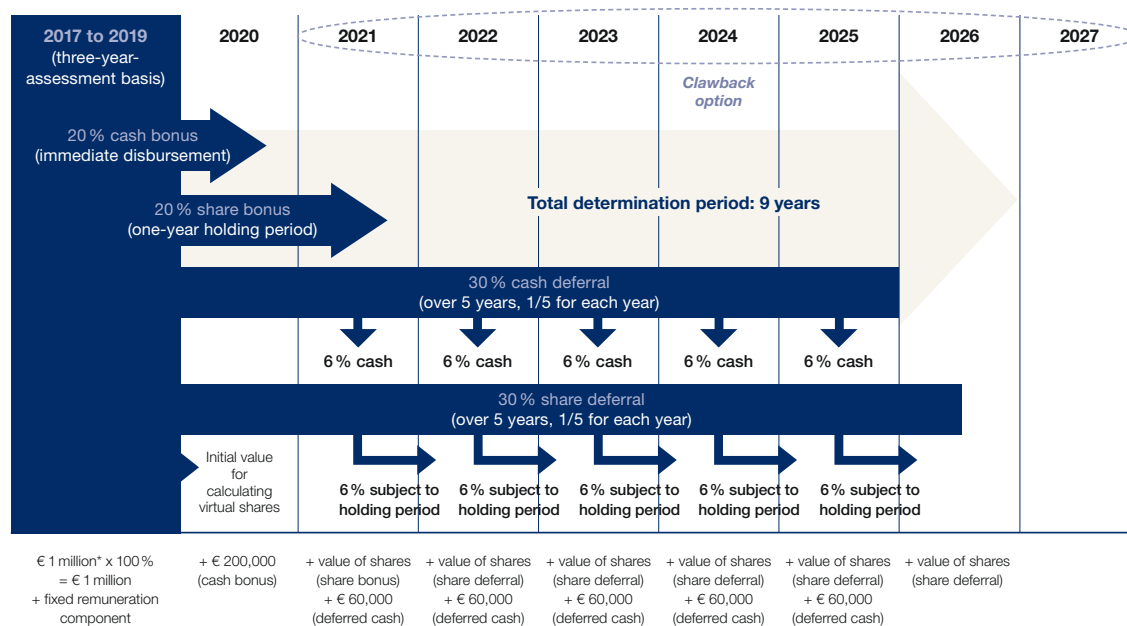
For the portion of performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one fifth of the

amount in the five years following the determination of the performance-related remuneration (cf. "Ex-post review of target achievement and behaviour of the Management Board").

Until the end of each respective deferral period, there is no right to the relevant remuneration components. No interest or dividends will accrue. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a one-year holding period.

**Sample disbursement methodology, based on 100 % target achievement for the 2019 financial year**

The Supervisory Board regularly examines, at the beginning of each year and prior to disbursement or conversion into virtual shares, whether the original target achievement still applies, and whether a penalty-triggering event has occurred which requires reduction or clawback of variable remuneration.



\*For the sake of simplicity of this sample presentation, variable remuneration for a 100% target achievement level was set to a notional value of € 1 million.

**Share bonus with holding period**

The portion of the performance-related remuneration which is subject to the share bonus plan will be converted into an equivalent number of virtual shares. The calculation of the number of virtual shares is based on the weighted average price on the basis of five (Xetra®) exchange trading days after publication of the preliminary results for the financial year for which the share bonus is granted (subscription price). The date of publication of the preliminary results is used as the reference date.

The virtual shares so determined are posted to a virtual account and are held for one year. They will be converted, automatically and without delay, into a cash amount and disbursed immediately after the Supervisory Board meeting which passes the resolution on the adoption of the annual financial statements for the first financial year following the financial year for which the virtual shares were granted ("holding period"). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the year preceding the payout.

The payout amount of the share bonus of a given financial year may vary depending on the share price development and has been limited to a maximum of 300% of the agreed initial value (ceiling).

**Share Deferral Plan**

In the five years following determination of performance-related remuneration (deferral period), the Supervisory Board decides whether in each case a fifth of the share deferral should be converted into virtual shares.



The rules of the Share Bonus Plan are applicable to the calculation of the number of virtual shares, subject to the proviso that the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the financial year in respect of which variable remuneration was determined. This is designed to preserve the reference to the original assessment period.

The ceiling value is applicable for the conversion of the virtual shares, with the proviso that the payout amount following the conversion of the virtual shares of a tranche into a cash payment must not exceed 300% of the share deferral (30% of the initial value of performance-related remuneration) set for the financial year in question (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin).

## **Ex-post review of target achievement and behaviour of the Management Board**

### **Backtesting regarding retained remuneration components**

Before the Supervisory Board decides on conversion or disbursement of retained remuneration components, it reviews whether the target achievement level originally agreed upon is still held to be correctly determined, based on current knowledge. For example, where an indicator used to determine remuneration needs to be adjusted ex-post, this can also reduce the variable remuneration determined – and hence, result in a reduction in the amount retained. If it turns out, at a later date, that a project did not achieve the objectives on which the original remuneration calculation was based, then the variable remuneration can also be reduced ex-post.

### **Penalty review**

When determining variable remuneration, as well as prior to every disbursement of cash components or conversion into virtual shares, the Supervisory Board verifies whether there are any reasons, besides the achievement of targets, for reducing variable remuneration, possibly to zero.

Such **penalty-triggering events** include inappropriate behaviour, behaviour in breach of duties, or negative performance contributions of Management Board members, which cannot be offset through positive performance contributions at other levels. For example, wilful breaches of the Code of Conduct, the corporate values determined therein and/or internal and/or external rules, conduct that damages the Bank's reputation, or other misconduct may give rise to a penalty. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. In the case of **negative performance contributions** in the form of significant losses or material regulatory sanctions, variable remuneration must be reduced to zero.

### **Clawbacks**

Starting with variable remuneration for the 2018 financial year, agreements with Management Board members ensure that any variable remuneration already disbursed must be reclaimed in the event of negative performance contributions (penalty review).

## **Restrictions and additional provisions**

### **Impact of special external conditions (modifiers)**

The Supervisory Board is entitled to increase or decrease the level of target achievement for the Group component by up to 20 percentage points (a so-called modifier) in the event of unforeseeable changes to the economic environment which are beyond the Management Board's influence or control (i.e. only on the basis of external conditions). This will not affect the restrictions set out below, especially the 150% cap, which cannot be circumvented by the modifier.

### **Hedging ban**

The contracts of Management Board members prohibit them from undertaking to limit or override the risk orientation of their remuneration by initiating personal protection or countermeasures (hedging ban).

### **Additional constraints regarding target achievement**

For the purpose of additional risk adjustment, for each financial year, the Supervisory Board sets lower thresholds in order to secure adherence of the regulatory capital adequacy and liquidity (Liquidity Coverage Ratio – LCR). For capital adequacy, this comprises a target ratio for Common Equity Tier 1 capital (CET1 ratio), for liquidity the adherence to the statutory Liquidity Coverage Ratio (LCR). No variable remuneration will be determined for any financial year where any of these two targets has not been achieved.

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### Risk-bearing capacity and parallel interest with shareholders

To preserve the Company's continued survival (and hence, shareholders' investment), variable remuneration is generally subject to a review performed by the Supervisory Board pursuant to section 7 of the InstVergV. This review is based on the Recovery Plan (which is mandatory for Aareal Bank as a significant institution) and the thresholds defined therein. These thresholds include achieving minimum profitability indicators such as the return on equity. In the event of these so-called "early warning thresholds" being reached, the Supervisory Board will decide, in its reasonable discretion, whether variable remuneration for the Management Board needs to be reduced. The total amount of variable remuneration is set to zero if Aareal Bank's risk-bearing capacity is no longer sufficiently ensured. In addition, pursuant to section 45 (2) sentence 1 no. 5a KWG, the German Federal Financial Supervisory Authority (BaFin) may impose further conditions or restrictions, or may instruct that the total amount of variable remuneration be cancelled.

### Rules governing severance pay

The agreements concluded with members of the Management Board do not include any obligation to make severance payments in cases involving the early termination of employment relationships (**rescission of the agreement without good cause**). However, severance payments may be included in individual termination agreements, provided that these are specified in accordance with regulatory requirements, in particular with the InstVergV. The agreements concluded with members of the Management Board state that, in the event of the premature termination of their term on the Management Board without good cause, payments, including ancillary benefits, made to the Management Board member in question must not exceed twice the annual remuneration (severance cap) and must not constitute remuneration for more than the remaining term of the employment contract.

In the case of a compulsory loss of a Management Board position (**change of control**), the Management Board members are to be paid the fixed remuneration component, the performance-based remuneration, as well as the contractually agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions; that is, in particular the deferral periods, the holding periods and the penalty rules are applicable.

In addition, the extent to which sectional and individual targets were achieved on average during the last three years prior to the termination of the Management Board position will be used as a basis to determine the target achievement level for the remaining term of the contract. In the case of a voluntary termination of the Management Board position following a change of control, the members of the Management Board merely receive the fixed remuneration and the contractually agreed benefits for the remainder of the contractual term. In this case, there is no entitlement to the variable remuneration component.

The total amount of payments in the case of termination due to a change of control is limited to 150% of the severance cap of an employment contract.

### Newcomer rule

The Supervisory Board intends to remunerate newly-appointed members who have not previously held a position on the Management Board of a comparable institution in line with an **entry level** of 80% of fixed and variable remuneration for ordinary members of the Management Board, reflecting lack of experience. If the Management Board member is re-appointed, the Supervisory Board will also decide upon the potential increase of remuneration to the normal level. However, since the Supervisory Board decided upon the specific selection as well as remuneration of individual Management Board members, within its reasonable discretion, and taking the Company's specific needs into account, it is possible to diverge from this rule.

When implementing the InstVergV, as amended on 3 July 2017, the Supervisory Board decided to only gradually build up the three-year assessment period; in the Supervisory Board's view, newly-appointed members of the Management Board should not be held accountable for past developments. In accordance with the regulatory requirements pursuant to the InstVergV, the deferral period is extended for periods with a shortened assessment period. Hence, for the first year, the assessment period is only one year, with the deferral period extended from five to seven years. For the second year, the assessment period is extended to two years and the deferral period shortened to six years. The remuneration system for the Management Board will be applied, as provided, from the third year onwards.

### Annual examination of appropriateness

The Supervisory Board regularly (at least annually) checks, whether Management Board and employee remuneration is appropriate (cf. remuneration governance). To evaluate whether the Manage-

ment Board's specific total remuneration is in line with common practice/that of other companies, the Supervisory Board has set two comparison groups. The companies are selected based on Aareal Bank's market position (particularly sector, size, country). Therefore, the comparison groups are MDAX companies and banks of a similar size.

## Remuneration of the Management Board

### Measures in the 2019 financial year

#### Remuneration increase for two Management Board members

In the 2019 financial year, the two ordinary Management Board members Christiane Kunisch-Wolff and Christof Winkelmann began their second term of office as Management Board members. Since they had previously both been subject to the newcomers rule, their remuneration was correspondingly increased with effect from their second term of office.

#### Realignment of the total remuneration structure

As mentioned above, the Supervisory Board has decided to realign the remuneration structure for Management Board members as of 2019; as such, basic remuneration will account for 45%, retirement benefits for 15%, and variable remuneration for 40% of total target remuneration. Within the scope of these changes, the fixed remuneration elements were increased for all members of the Management Board, whilst their target variable remuneration elements were lowered. No total target remuneration change was associated with these amendments.

### Target achievement in the 2019 financial year

#### Target achievement

The assessment of the single targets regarding variable remuneration in the year under review yielded the following results:

	Hermann J. Merkens	Marc Hess <sup>1)</sup>	Dagmar Knopek	Christiane Kunisch-Wolff	Thomas Ortmanns	Christof Winkelmann
%						
<b>2019</b>	<b>Overall Bank performance</b>					
	<b>100.0</b>					
	Sectional targets	100.0	100.0	100.0	100.0	100.0
	Individual targets	110.0	110.0	100.0	100.0	110.0
<b>Overall target achievement for 2019, based on a three-year observation period</b>		<b>103.1</b>	<b>101.1</b>	<b>100.4</b>	<b>102.2</b>	<b>102.1</b>
<b>Amount of variable remuneration (€)</b>	<b>1,289,126</b>	<b>788,190</b>	<b>783,354</b>	<b>768,770</b>	<b>796,224</b>	<b>733,882</b>

<sup>1)</sup> Given that Mr Hess joined the Bank in 2018, no target achievement levels for the year 2017 are considered in his case.

### Group performance targets 2019

As mentioned, consolidated operating profit (as communicated to shareholders) and a target value for RWAs were chosen as income targets, both of which boasted 100% target achievement.

#### Sectional and individual targets 2019

Notwithstanding the Management Board's overall responsibility for the Bank's management, specific sectional and individual targets were agreed upon for each Management Board member. Whilst the individual targets reflect especially the individual contributions of each Management Board member, the sectional targets are meant to reflect the target achievement of the respective Management Board member's area of responsibility. Thus, the strategic initiatives and measures defined and implemented in the respective area of responsibility are the main basis for determining sectional targets. Furthermore, various ESG targets (derived from the business strategy) have been agreed upon on both levels.

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Within the scope of their sectional and individual targets, all Management Board members were required to interlink the different processes in their areas of responsibility to an even greater extent (for Mr Merkens, e.g., the even more efficient interlinking of strategy and risk processes), to adhere to cost plans, and to promote the risk and corporate culture. The latter was reviewed within the course of a broad-based employee survey conducted in 2019, leading to measures aimed at promoting the Bank's risk and corporate culture. Implementation of these measures shall be reviewed within the scope of the individual targets 2020.

Apart from that, the following sectional and/or individual targets were defined for the individual Management Board members:

**Hermann-Josef Merkens**

Mr Merkens' targets include: increasing flexibility and efficiency of the Group organisation, improving the statement of financial position and strengthening equity, whilst expanding the business along the strategic benchmark, strengthening and developing the Aareal 2020 strategy, and preparing the strategic programme following Aareal 2020. The latter was achieved through "Aareal Next Level".

**Marc Hess**

Mr Hess' sectional and individual targets included integrating Düsseldorfer Hypothekenbank AG (now DHB Verwaltungs AG) – achieved during the year –, developing the concept for and implementing the process to select a new external auditor to be proposed to the Annual General Meeting (appointment to review, if applicable, the first-quarter interim financial information 2021), and adjusting the funding mix.

**Christiane Kunisch-Wolff**

Ms Kunisch-Wolff's targets comprised achieving closer links with supervisory authorities, optimising risk management-related management impulses relevant to the Group, and setting up Aareal Bank to anticipate (and plan in a timely manner) future and existing requirements, including the implementation of core regulatory projects.

**Dagmar Knopek**

Ms Knopek targeted the reduction of the NPL portfolio and the promotion of digitalisation initiatives in her area of responsibility.

**Thomas Ortmanns**

Mr Ortmanns' targets concerned, among other things, implementing the digitalisation strategy and measures to expand the commission-based business in the housing industry, improving Aareon's results, and managing the implementation of various IT projects.

**Christof Winkelmann**

Mr Winkelmann's sectional targets included implementing the business plan in the business division he is responsible for, and further improving the syndication process. These targets were measured, among other things, by considering specific country or property type portfolio volumes.

**No penalty-triggering events**

In addition, compliance with governance provisions, i.e., with internal and external rules, as well as with the corporate values determined in Aareal Bank Group's Code of Conduct, is assessed within the scope of the annual penalty review. However, no such penalty-triggering events were found.

## Total remuneration

In accordance with German commercial law in conjunction with GAS 17, the following table shows fixed and other remuneration for members of the Management Board, variable remuneration determined for the respective financial year (total amount, plus a breakdown into its components), as well as the total target achievement levels, as determined by the Supervisory Board:

	Current year	Fixed remuneration	Variable remuneration					Ancillary benefits	Total remuneration	
			Cash component		Share-based component		Target achievement level <sup>2)</sup>			Total
			Cash bonus	Cash deferral <sup>1)</sup>	Share bonus	Share deferral <sup>1)</sup>				
€										
Hermann J. Merkens	2019	1,425,000	257,825	386,738	257,825	386,738	103.1%	1,289,126	36,079	2,750,205
	2018	1,300,000	304,248	456,372	304,248	456,372	108.7%	1,521,240	34,024	2,855,264
Marc Hess <sup>3)</sup>	2019	900,000	157,638	236,457	157,638	236,457	101.1%	788,190	39,855	1,728,045
	2018	220,000	40,329	60,493	40,329	60,493	100.0%	201,644	3,244	424,888
Dagmar Knopek	2019	900,000	156,671	235,006	156,671	235,006	100.4%	783,354	56,012	1,739,366
	2018	880,000	164,256	246,384	164,256	246,384	102.7%	821,280	19,598	1,720,878
Christiane Kunisch-Wolff	2019	859,957	153,754	230,631	153,754	230,631	102.2%	768,770	34,797	1,663,524
	2018	704,000	139,085	208,627	139,085	208,627	108.7%	695,424	25,466	1,424,890
Thomas Ortmanns	2019	900,000	159,245	238,867	159,245	238,867	102.1%	796,224	40,678	1,736,902
	2018	880,000	173,856	260,784	173,856	260,784	108.7%	869,280	18,504	1,767,784
Christof Winkelmann	2019	802,000	146,776	220,165	146,776	220,165	103.3%	733,882	38,245	1,574,127
	2018	704,000	139,085	208,627	139,085	208,627	108.7%	695,424	70,329	1,469,753
<b>Total</b>	<b>2019</b>	<b>5,786,957</b>	<b>1,031,909</b>	<b>1,547,864</b>	<b>1,031,909</b>	<b>1,547,864</b>	<b>102.1%</b>	<b>5,159,546</b>	<b>245,666</b>	<b>11,192,169</b>
	<b>2018</b>	<b>4,688,000</b>	<b>960,859</b>	<b>1,441,287</b>	<b>960,859</b>	<b>1,441,287</b>	<b>107.2%</b>	<b>4,804,292</b>	<b>171,165</b>	<b>9,663,457</b>

<sup>1)</sup> The deferrals shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.

<sup>2)</sup> 2018: excluding the positive non-recurring effect (negative goodwill) from the acquisition of former Düsselhyp

<sup>3)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

No benefits were granted to any member of the Management Board by third parties with respect to his/her Management Board activities during the year under review. Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 2,3 million (2018: € 3.0 million).

## (Virtual) shareholdings of Management Board members and share-based remuneration

Within Aareal Bank's remuneration system for Management Board members, the reference value for 100% target achievement is slightly below the respective basic salary. Given that 50% of variable remuneration is disbursed in the form of virtual shares, Management Board members typically earn virtual shares amounting to more than 100% of their fixed annual salary at the latest after three years of service. provided that they also earn variable remuneration in subsequent years, the equivalent value of the virtual shares will not fall below this 100% threshold until the end of their term on the Management Board.

The following table shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2019 and 2018, respectively – as well as the number of virtual shares already held as at the reporting date:

	Year	Share-based payment		Total quantity of virtual shares held (31 December)
		Value (€)	Quantity (number) <sup>1)</sup>	Quantity (number)
Hermann J. Merkens	2019	644,563	21,308	58,753
	2018	760,620	28,182	55,340
Marc Hess <sup>2)</sup>	2019	394,095	13,028	1,405
	2018	100,822	3,736	-
Dagmar Knopek	2019	391,677	12,948	35,689
	2018	410,640	15,215	36,772
Christiane Kunisch-Wolff	2019	384,385	12,707	18,504
	2018	347,712	12,883	9,726
Thomas Ortmanns	2019	398,112	13,161	35,942
	2018	434,640	16,104	38,112
Christof Winkelmann	2019	366,941	12,130	15,751
	2018	347,712	12,883	7,659
<b>Total</b>	<b>2019</b>			<b>166,044</b>
	<b>2018</b>			<b>147,609</b>

<sup>1)</sup> The stated number of virtual shares granted for 2019 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2019 (€ 30.25). The final conversion rate may only be determined after publication of preliminary results for 2019. The stated number of virtual shares granted for 2018 differs slightly from the previous year's figure since the former was calculated using a final conversion rate of € 28.71.

<sup>2)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

### Target remuneration granted

The following table shows the target remuneration (fixed annual salary and variable remuneration based on a 100% target achievement) for the year under review, in accordance with articles 4.2.4 and 4.2.5 of the German Corporate Governance Code:

Remuneration granted	Hermann J. Merkens – Chairman of the Management Board			
	2018	2019	2019 (min) <sup>1)</sup>	2019 (max) <sup>2)</sup>
€				
Fixed remuneration	1,300,000	1,425,000	1,425,000	1,425,000
Ancillary benefits	34,024	36,079	36,079	36,079
<b>Total</b>	<b>1,334,024</b>	<b>1,461,079</b>	<b>1,461,079</b>	<b>1,461,079</b>
One-year variable remuneration	280,000	250,000	-	375,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	420,000	-	-	-
Share bonus 2018 (March 2019)	280,000	-	-	-
Share deferral 2018 (March 2024)	420,000	-	-	-
Cash deferral 2019 (March 2025)	-	375,000	-	562,000
Share bonus 2019 (March 2020)	-	250,000	-	375,000
Share deferral 2019 (March 2025)	-	375,000	-	562,000
<b>Total</b>	<b>1,400,000</b>	<b>1,250,000</b>	<b>-</b>	<b>1,874,000</b>
Benefit expense	847,178	2,297,353	2,297,353	2,297,353
<b>Total remuneration</b>	<b>3,581,202</b>	<b>5,008,432</b>	<b>3,758,432</b>	<b>5,632,432</b>

<sup>1)</sup> Minimum amount of the remuneration component granted in the year under review

<sup>2)</sup> Maximum amount of the remuneration component granted in the year under review

Remuneration granted	Marc Hess <sup>3)</sup>			
	2018	2019	2019 (min) <sup>1)</sup>	2019 (max) <sup>2)</sup>
€				
Fixed remuneration	220,000	900,000	900,000	900,000
Ancillary benefits	3,244	39,855	39,855	39,855
<b>Total</b>	<b>223,244</b>	<b>939,855</b>	<b>939,855</b>	<b>939,855</b>
One-year variable remuneration	40,329	156,000	-	234,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2026)	60,493	-	-	-
Share bonus 2018 (March 2019)	40,329	-	-	-
Share deferral 2018 (March 2026)	60,493	-	-	-
Cash deferral 2019 (March 2026)	-	234,000	-	351,000
Share bonus 2019 (March 2020)	-	156,000	-	234,000
Share deferral 2019 (March 2026)	-	234,000	-	351,000
<b>Total</b>	<b>201,644</b>	<b>780,000</b>	-	<b>1,170,000</b>
Benefit expense	148,056	754,139	754,139	754,139
<b>Total remuneration</b>	<b>572,944</b>	<b>2,473,994</b>	<b>1,693,994</b>	<b>2,863,994</b>

Remuneration granted	Dagmar Knopek			
	2018	2019	2019 (min) <sup>1)</sup>	2019 (max) <sup>2)</sup>
€				
Fixed remuneration	880,000	900,000	900,000	900,000
Ancillary benefits	19,598	56,012	56,012	56,012
<b>Total</b>	<b>899,598</b>	<b>956,012</b>	<b>956,012</b>	<b>956,012</b>
One-year variable remuneration	160,000	156,000	-	234,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	240,000	-	-	-
Share bonus 2018 (March 2019)	160,000	-	-	-
Share deferral 2018 (March 2024)	240,000	-	-	-
Cash deferral 2019 (March 2025)	-	234,000	-	351,000
Share bonus 2019 (March 2020)	-	156,000	-	234,000
Share deferral 2019 (March 2025)	-	234,000	-	351,000
<b>Total</b>	<b>800,000</b>	<b>780,000</b>	-	<b>1,170,000</b>
Benefit expense	488,691	780,217	780,217	780,217
<b>Total remuneration</b>	<b>2,188,289</b>	<b>2,516,229</b>	<b>1,736,229</b>	<b>2,906,229</b>

<sup>1)</sup> Minimum amount of the remuneration component granted in the year under review

<sup>2)</sup> Maximum amount of the remuneration component granted in the year under review

<sup>3)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

Remuneration granted	Christiane Kunisch-Wolff			
	2018	2019	2019 (min) <sup>1)</sup>	2019 (max) <sup>2)</sup>
€				
Fixed remuneration	704,000	859,957	859,957	859,957
Ancillary benefits	25,466	34,797	34,797	34,797
<b>Total</b>	<b>729,466</b>	<b>894,754</b>	<b>894,754</b>	<b>894,754</b>
One-year variable remuneration	128,000	150,400	-	225,600
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	192,000	-	-	-
Share bonus 2018 (March 2019)	128,000	-	-	-
Share deferral 2018 (March 2024)	192,000	-	-	-
Cash deferral 2019 (March 2025)	-	225,600	-	338,400
Share bonus 2019 (March 2020)	-	150,400	-	225,600
Share deferral 2019 (March 2025)	-	225,600	-	338,400
<b>Total</b>	<b>640,000</b>	<b>752,000</b>	-	<b>1,128,000</b>
Benefit expense	422,142	826,324	826,324	826,324
<b>Total remuneration</b>	<b>1,791,608</b>	<b>2,473,078</b>	<b>1,721,078</b>	<b>2,849,078</b>

Remuneration granted	Thomas Ortmanns			
	2018	2019	2019 (min) <sup>1)</sup>	2019 (max) <sup>2)</sup>
€				
Fixed remuneration	880,000	900,000	900,000	900,000
Ancillary benefits	18,504	40,678	40,678	40,678
<b>Total</b>	<b>898,504</b>	<b>940,678</b>	<b>940,678</b>	<b>940,678</b>
One-year variable remuneration	160,000	156,000	-	234,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	240,000	-	-	-
Share bonus 2018 (March 2019)	160,000	-	-	-
Share deferral 2018 (March 2024)	240,000	-	-	-
Cash deferral 2019 (March 2025)	-	234,000	-	351,000
Share bonus 2019 (March 2020)	-	156,000	-	234,000
Share deferral 2019 (March 2025)	-	234,000	-	351,000
<b>Total</b>	<b>800,000</b>	<b>780,000</b>	-	<b>1,170,000</b>
Benefit expense	621,605	1,610,588	1,610,588	1,610,588
<b>Total remuneration</b>	<b>2,320,109</b>	<b>3,331,266</b>	<b>2,551,266</b>	<b>3,721,266</b>

Remuneration granted	Christof Winkelmann			
	2018	2019	2019 (min) <sup>1)</sup>	2019 (max) <sup>2)</sup>
€				
Fixed remuneration	704,000	802,000	802,000	802,000
Ancillary benefits	70,329	38,245	38,245	38,245
<b>Total</b>	<b>774,329</b>	<b>840,245</b>	<b>840,245</b>	<b>840,245</b>
One-year variable remuneration	128,000	142,115	-	213,173
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	192,000	-	-	-
Share bonus 2018 (March 2019)	128,000	-	-	-
Share deferral 2018 (March 2024)	192,000	-	-	-
Cash deferral 2019 (March 2025)	-	213,173	-	319,759
Share bonus 2019 (March 2020)	-	142,115	-	213,173
Share deferral 2019 (March 2025)	-	213,173	-	319,759
<b>Total</b>	<b>640,000</b>	<b>710,576</b>	-	<b>1,065,864</b>
Benefit expense	498,191	1,435,786	1,435,786	1,435,786
<b>Total remuneration</b>	<b>1,912,520</b>	<b>2,986,607</b>	<b>2,276,031</b>	<b>3,341,895</b>

<sup>1)</sup> Minimum amount of the remuneration component granted in the year under review

<sup>2)</sup> Maximum amount of the remuneration component granted in the year under review



## Remuneration paid

The following table shows the remuneration disbursed in the year under review, as defined in sections 4.2.4 and 4.2.5 of the German Corporate Governance Code. It also outlines disbursements under variable remuneration components related to multiple years which expired during the year under review:

Remuneration paid	Hermann J. Merkens Chairman of the Management Board		Marc Hess <sup>1)</sup>		Dagmar Knopek		Christiane Kunisch-Wolff	
	2019	2018	2019	2018	2019	2018	2019	2018
€								
Fixed remuneration	1,425,000	1,300,000	900,000	220,000	900,000	880,000	859,957	704,000
Ancillary benefits	36,079	34,024	39,855	3,244	56,012	19,598	34,797	25,466
<b>Total</b>	<b>1,461,079</b>	<b>1,334,024</b>	<b>939,855</b>	<b>223,244</b>	<b>956,012</b>	<b>899,598</b>	<b>894,754</b>	<b>729,466</b>
One-year variable remuneration	304,248	343,994	40,329	-	164,256	196,568	139,085	157,254
Multi-year variable remuneration	-	-	-	-	-	-	-	-
Cash deferral 2014 (April 2018)	-	103,957	-	-	-	103,711	-	-
Cash deferral 2015 (April 2018)	-	151,605	-	-	-	107,621	-	-
Cash deferral 2016 (April 2018)	-	189,653	-	-	-	106,606	-	67,939
Share bonus 2014 (April 2018)	-	199,945	-	-	-	199,471	-	-
Share deferral 2012 (April 2018)	-	249,699	-	-	-	-	-	-
Share deferral 2013 (April 2018)	-	135,779	-	-	-	79,204	-	-
Share deferral 2014 (April 2018)	-	100,872	-	-	-	100,633	-	-
Cash deferral 2015 (April 2019)	152,530	-	-	-	108,278	-	-	-
Cash deferral 2016 (April 2019)	190,450	-	-	-	107,054	-	68,224	-
Cash deferral 2017 (April 2019)	172,613	-	-	-	98,638	-	78,910	-
Share bonus 2015 (April 2019)	312,384	-	-	-	221,754	-	-	-
Share deferral 2013 (April 2019)	101,264	-	-	-	59,071	-	-	-
Share deferral 2014 (April 2019)	74,734	-	-	-	74,557	-	-	-
Share deferral 2015 (April 2019)	157,145	-	-	-	111,553	-	-	-
Dividends	128,964	138,349	2,950	-	78,046	91,929	41,361	24,316
<b>Total</b>	<b>1,594,332</b>	<b>1,613,853</b>	<b>43,279</b>	<b>-</b>	<b>1,023,207</b>	<b>985,743</b>	<b>327,580</b>	<b>249,509</b>
Benefit expense	2,297,353	847,178	754,139	148,056	780,217	488,691	826,324	422,142
<b>Total remuneration</b>	<b>5,352,764</b>	<b>3,795,055</b>	<b>1,737,273</b>	<b>371,300</b>	<b>2,759,436</b>	<b>2,374,032</b>	<b>2,048,658</b>	<b>1,401,117</b>

<sup>1)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

Remuneration paid	Thomas Ortmanns		Christof Winkelmann		Dr Wolf Schumacher <sup>1)</sup>		Dirk Große Wördemann <sup>2)</sup>	
	2019	2018	2019	2018	2019	2018	2019	2018
€								
Fixed remuneration	900,000	880,000	802,000	704,000	-	-	-	-
Ancillary benefits	40,678	18,504	38,245	70,329	-	-	-	-
<b>Total</b>	<b>940,678</b>	<b>898,504</b>	<b>840,245</b>	<b>774,329</b>	-	-	-	-
One-year variable remuneration	173,856	194,168	139,085	159,174	-	-	-	-
Multi-year variable remuneration	-	-	-	-	-	-	-	-
Cash deferral 2014 (April 2018)	-	103,135	-	-	-	181,493	-	-
Cash deferral 2015 (April 2018)	-	106,973	-	-	-	139,658	-	-
Cash deferral 2016 (April 2018)	-	107,249	-	42,739	-	-	-	-
Share bonus 2014 (April 2018)	-	198,365	-	-	-	349,075	-	-
Share deferral 2012 (April 2018)	-	249,699	-	-	-	421,271	-	202,720
Share deferral 2013 (April 2018)	-	135,779	-	-	-	229,075	-	-
Share deferral 2014 (April 2018)	-	100,075	-	-	-	176,108	-	-
Cash deferral 2015 (April 2019)	107,626	-	-	-	140,510	-	-	-
Cash deferral 2016 (April 2019)	107,669	-	42,918	-	-	-	-	-
Cash deferral 2017 (April 2019)	97,434	-	79,874	-	-	-	-	-
Share bonus 2015 (April 2019)	220,419	-	-	-	287,767	-	-	-
Share deferral 2013 (April 2019)	101,264	-	-	-	170,844	-	-	-
Share deferral 2014 (April 2019)	74,144	-	-	-	130,475	-	-	-
Share deferral 2015 (April 2019)	110,882	-	-	-	144,761	-	-	-
Dividends	78,565	95,279	35,240	19,149	31,001	88,048	-	-
<b>Total</b>	<b>1,071,859</b>	<b>1,290,722</b>	<b>297,117</b>	<b>221,062</b>	<b>905,358</b>	<b>1,584,728</b>	-	<b>202,720</b>
Benefit expense	1,610,588	621,605	1,435,786	498,191	-	-	-	-
<b>Total remuneration</b>	<b>3,623,125</b>	<b>2,810,831</b>	<b>2,573,148</b>	<b>1,493,582</b>	<b>905,358</b>	<b>1,584,728</b>	-	<b>202,720</b>

<sup>1)</sup> Dr Wolf Schumacher resigned with effect from 30 September 2015.

<sup>2)</sup> Dirk Große Wördemann resigned with effect from 31 May 2013.

## Pensions

	2019			2018		
	Pension claims p.a. <sup>1)</sup>	Balance of pension obligations (IFRS) as at 31 Dec 2019	Increase of pension obligations (IFRS) in 2019	Pension claims p.a. <sup>1)</sup>	Balance of pension obligations (IFRS) as at 31 Dec 2018	Increase of pension obligations (IFRS) in 2018
000's €						
Hermann J. Merkens	371	9,567	2,297	345	7,270	847
Marc Hess <sup>2)</sup>	35	902	754	7	148	148
Dagmar Knopek	127	3,290	780	110	2,510	489
Christiane Kunisch-Wolff	75	1,998	826	54	1,172	422
Thomas Ortmanns	294	7,967	1,610	284	6,357	622
Christof Winkelmann	92	2,664	1,436	65	1,228	498
<b>Total</b>	<b>994</b>	<b>26,388</b>	<b>7,703</b>	<b>865</b>	<b>18,685</b>	<b>3,026</b>

<sup>1)</sup> The pension claims mentioned refer to old-age pension earned as at 31 December of the year under review, based on the Company's contributions, if retired at the pertinent retirement age. To enhance comparability with other disclosures, the overview in the year under review and the previous-year figures were adjusted.

<sup>2)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

Service cost (in accordance with IFRSs) incurred in the 2019 financial year in connection with the pension claims of members of the Management Board totalled € 3.6 million (2018: € 2.7 million). The pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 10.3 million in the year under review (2018: € 2.8 million). The stronger increase in pension obligations year-on-year is mainly due to the significantly lower imputed rate of interest. The total amount of pension obligations was € 61.8 million (2018: € 51.5 million). Of that amount, € 35.4 million related to former members of the Management Board and their surviving dependants (2018: € 32.8 million).

## Remuneration system for members of the Supervisory Board

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG. Remuneration for the services of the Supervisory Board members comprises exclusively fixed remuneration, plus an attendance fee. Where membership in the Supervisory Board falls short of an entire financial year, said remuneration shall be paid on a pro rata temporis basis. Furthermore, the Supervisory Board members will be reimbursed for their expenses. Any value-added tax invoiced will also be deemed to be a refundable expense.

Remuneration of the Supervisory Board comprises the following:

Remuneration element	Description	Structure
Fixed remuneration	Remuneration for activities in the Supervisory Board; Depending on the role of the respective Supervisory Board member (e.g. Chairman)	€ 50,000 p.a. per Supervisory Board member € 150,000 p.a. for the Chairman € 75,000 p.a. for the Deputy Chairman
Committee remuneration	Remuneration for activities and duties on the Supervisory Board committees also depends on the role of the respective Supervisory Board member in the respective committee (e.g. a committee chairman)	€ 20,000 p.a. each for membership in the Risk Committee and/or the Audit Committee € 40,000 p.a. each for the chairmanship in the two committees € 15,000 p.a. each for membership in other committees € 30,000 p.a. each for the chairmanship in other committees
Attendance fees	Remuneration for participation in Supervisory Board meetings and on the committees of the Supervisory Board	€ 1,000 per meeting

The remuneration for any financial year shall be due and payable one month after the end of the respective financial year.

## Supervisory Board remuneration

€	Year	Fixed remuneration	Attendance fees	Total remuneration
Marija Korsch	2019	265,000	37,000	302,000
Chairman	2018	265,000	36,000	301,000
Prof. Dr Stephan Schüller	2019	125,000	23,000	148,000
Deputy Chairman	2018	125,000	27,000	152,000
Klaus Novatius	2019	105,000	21,000	126,000
Deputy Chairman (from 1 January 2019)	2018	-	-	-
Dieter Kirsch, Deputy Chairman	2019	-	-	-
(31 March to 31 December 2018)	2018	100,000	20,000	120,000
York-Detlef Bülow	2019	-	-	-
Deputy Chairman (until 31 March 2018)	2018	31,250	9,000	40,250
Thomas Hawel	2019	65,000	13,000	78,000
	2018	65,000	12,000	77,000
Petra Heinemann-Specht	2019	70,000	15,000	85,000
(From 1 April 2018)	2018	52,500	10,000	62,500
Richard Peters	2019	100,000	25,000	125,000
	2018	100,000	23,000	123,000
Dr Hans-Werner Rhein	2019	85,000	21,000	106,000
	2018	85,000	16,000	101,000
Sylvia Seignette	2019	90,000	15,000	105,000
	2018	90,000	13,000	103,000
Elisabeth Stheeman <sup>1)</sup>	2019	85,000	19,000	104,000
	2018	85,000	17,000	102,000
Hans-Dietrich Voigtländer	2019	115,000	25,000	140,000
	2018	115,000	26,000	141,000
Prof. Dr Hermann Wagner	2019	110,000	21,000	131,000
	2018	110,000	19,000	129,000
Beate Wollmann	2019	70,000	15,000	85,000
	2018	65,000	12,000	77,000
<b>Total</b>	<b>2019</b>	<b>1,285,000</b>	<b>250,000</b>	<b>1,535,000</b>
	<b>2018</b>	<b>1,288,750</b>	<b>240,000</b>	<b>1,528,750</b>

<sup>1)</sup> Income tax plus solidarity surcharge for the Supervisory Board member subject to limited tax liability was declared pursuant to section 50a (1) no. 4 of the German Income Tax Act (Einkommensteuergesetz – "EStG"), and paid to the German Central Tax Office (Bundeszentralamt für Steuern, BZSt).

## Remuneration system for employees

When it comes to the structure of the remuneration system for employees, a general distinction is made between three groups of employees. First of all, Aareal Bank has employees whose remuneration is governed by collective agreements. Then, there are employees whose remuneration is not governed by collective agreements. These employees who are not covered by collective agreements are then split into two further groups. First, there are those employees whose duties have a material impact on the overall risk profile of Aareal Bank (risk takers) or of Aareal Bank Group (Group risk takers). The variable remuneration paid to these "risk takers" is subject to very stringent regulatory requirements. The other employees who are not covered by collective agreements and are not risk takers either are not subject to these provisions and make up the third group.

The report below starts by explaining the remuneration system for risk takers and then addresses the differences compared with the other groups.

### Remuneration system for risk takers

In order to identify those employees who are classed as "risk takers", Aareal Bank carries out an annual independent risk analysis, identifying the employees in question based on a uniform set of criteria whilst taking regulatory requirements into account.

The remuneration system for risk takers is subject to the same basic conditions as the remuneration system for Management Board members, and is also aligned with the business and risk strategy of Aareal Bank AG and Aareal Bank Group respectively. As is the case with the Management Board remuneration, risk takers receive both fixed and variable remuneration. The fixed component comprises a fixed annual salary and ancillary benefits.

### **Performance-related variable remuneration**

#### **Remuneration parameters and target level weighting**

As with the Management Board members, the variable remuneration is measured based on targets derived from the corporate strategy. One difference compared with the Management Board system is that the assessment period for the target achievement is one year. The targets set for risk takers are split into three components that are added together, as is the case for the remuneration paid to the Management Board: a Group component, an organisational unit component (referring to the organisational unit that the risk taker works for) and an individual component (individual target achievement). The performance of the organisational unit for divisions allocated to Sales is measured using the Structured Property Financing segment operating result, as well as in terms of risk weighted assets. The performance of the Housing Industry division is measured by reference to the segment operating result of the Consulting/Services segment. The other organisational units, i.e. in particular central staff functions and control units, as well as the Treasury division, are measured based on their cost target. The remuneration system also takes account of the risk taker's position in the organisation's hierarchy, reflecting the influence that he/she can exert over the Group's/Bank's success. This results in differences in the weighting attached to the three additive components depending on an individual's responsibility within the Company: The Group component payable to risk takers assigned to the management level below the Management Board (Managing Directors) is 35%. By contrast, it is 25% for the other risk takers. For further information on the individual targets and possible resulting KPIs, we refer to the information on Management Board remuneration.

#### **Deferred disbursement, through retention of variable remuneration components and virtual shares**

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is generally paid out on a deferred basis after the end of the financial year. The payout terms are based on those that apply to the Management Board remuneration system but once again vary depending on the risk taker's position within the organisational structure.

60% of the variable remuneration paid to risk takers on the Managing Director level is subject to a five-year deferral period. As with the variable Management Board remuneration, 50% each of deferred and non-deferred components are converted into virtual shares that are held for a minimum period of one year. Unlike with the Management Board remuneration system, risk takers can, however, opt to select when they want their virtual shares to be converted into cash after the end of the one-year holding period, selecting a conversion date that falls within a period of up to three years.

By contrast, 40% of the variable remuneration paid to the other risk takers is subject to deferral over a period of three years.

All other aspects relating to the calculation of virtual shares are explained in the section on the Management Board remuneration system.

#### **Ex-post review of target achievement and behaviour of the risk takers**

As in the Management Board remuneration system, the original target achievement level is back-tested and, where appropriate, reduced before virtual shares are paid out/granted. Penalty-triggering events can also result in reductions or in the forfeiture of the variable remuneration entitlement in full and, as a result, also in variable remuneration that has already been paid out being clawed back. Details can be found in the information on the Management Board remuneration system.

### **Remuneration system for employees who are not classed as risk takers**

Aareal Bank AG is a member in Germany of the Arbeitgeberverband des privaten Bankgewerbes e.V. (association of employers in private banking) and bound by the collective agreements for private banks. As of the 2019 financial year, variable remuneration for employees not classified as risk takers has been split into two components, too: the Group component (25% of target variable remuneration) and the individual component (75% of target variable remuneration). As a result, the variable remuneration of all employees is directly linked to Aareal Bank Group's performance, and the employees are directly involved in reaching the communicated targets. The individual component paid to those employees whose remuneration is governed by a collective agreement is based

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on an annual appraisal. The initial value for measuring the variable remuneration corresponds to 0.75 gross monthly salaries for employees covered by a collective agreement. The individual component paid to those employees who are not covered by a collective agreement is based on contractually agreed target-variable remuneration and is measured based on an annual overall appraisal that also takes the target achievement level for the individual targets that have been set for the employee in question into account.

### **Restrictions and link to risk-bearing capacity for all employee remuneration systems**

All employee remuneration systems feature provisions corresponding to those found in the Management Board remuneration system regarding the impact of special external conditions (modifiers). In cases involving risk takers, the ban on hedging also applies. There are, however, differences with regard to the caps and the safeguarding of the risk-bearing capacity. The contracts of employment with those employees below Management Board level do not include contractual provisions on severance pay.

### **Caps and proportion of variable remuneration**

The core components and – for risk takers – the organisational components are capped at 150% in the target achievement level. The individual targets are capped at a target achievement level of 200%. If the individual target achievement level is 0%, no variable remuneration is paid at all. Performance of virtual shares is capped at 300%.

In order to comply with the requirements set out in section 25a (5) KWG, the reference value for the variable remuneration in cases involving a target achievement level of 100% generally corresponds to a maximum of 50% of the fixed remuneration. This means that, even if an employee achieves the maximum target achievement level, the variable remuneration does not exceed the fixed remuneration. Consequently, if an employee receives fixed annual remuneration of € 80,000, for example, the reference value for the variable remuneration paid out if that employee achieves 100% target achievement is limited to a maximum of € 40,000. It is very common, however, for variable remuneration to account for a smaller proportion of an employee's total remuneration. Furthermore, it has been ensured in line with regulatory requirements that the variable remuneration for control unit employees amounts to no more than one-third of total remuneration.

In 2014, the Annual General Meeting of Aareal Bank AG approved exemptions from this 1:1 rule for certain groups of employees. In order to ensure that the remuneration paid by Aareal Bank AG and its international subsidiaries is competitive in an international comparison, employees working in international sales at Aareal Bank AG, as well as executives and employees working for the subsidiaries Aareal Capital Corporation, New York, and Aareal Bank Asia Ltd., Singapore, have to be paid remuneration in line with local market standards. This applies to fewer than 25 positions.

### **Material amendments to the remuneration systems last year**

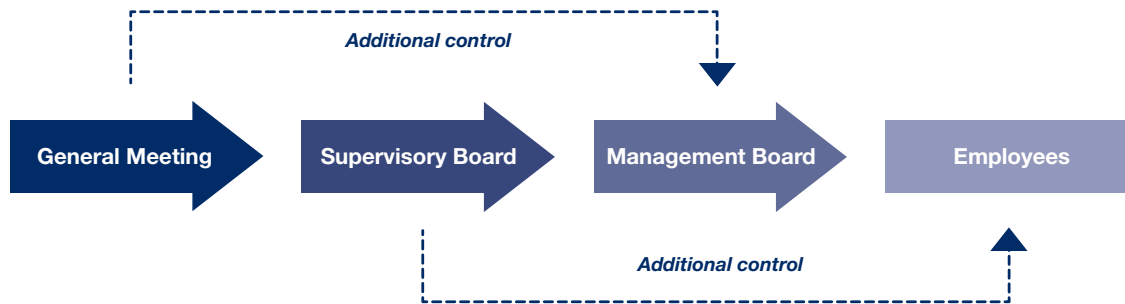
The material amendment to the remuneration systems for employees in the financial year under review concerned the aforementioned introduction of a Group component for the employees that were not identified as risk takers. In addition, this had the effect of reorganising the managing director level, whereby previously different positions were combined to create a uniform Managing Directors' level. This was accompanied by a standardisation in relation to the composition of the individual components of the target variable remuneration.

### **Reporting on quantitative disclosure requirements**

This report only covers the qualitative disclosure requirements regarding employee remuneration set out in Article 450 of the EU's Capital Requirements Regulation 2013/575 (CRR) and section 16 InstVergV. The quantitative disclosure requirements relating to the provisions set out above are published in a separate report entitled "Disclosure of Remuneration Indicators", which can be found on the website of Aareal Bank AG. This report will be made available within six months of the end of the financial year: <https://www.aareal-bank.com/en/investors-portal/finance-information/regulatory-disclosures/archive/2019/>

## Remuneration governance

### Determination and control of remuneration systems



### Governance of Supervisory Board remuneration

#### The role of the Annual General Meeting

Given the Supervisory Board's role as a supervisory body, remuneration for its members must not provide any incentives which would counter this surveillance function. The Annual General Meeting (AGM) determines the remuneration of the Supervisory Board, in Aareal Bank AG's Memorandum and Articles of Association; the AGM therefore also resolves on any adjustments to Supervisory Board remuneration (cf. Article 9 (4) and (5) of the Memorandum and Articles of Association).

In the implementation of the Second Shareholder Rights Directive in the German Public Limited Companies Act (AktG), as of the first ordinary Annual General Meeting following the 2020 financial year, the AGM will need to discuss Supervisory Board remuneration at least every four years, even without any concrete proposals for amendments, and will need to resolve whether it still approves it.

#### The role of the Supervisory Board

The Supervisory Board shall review the appropriateness of remuneration for its members at least once a year. Every four years, it shall retain an external remuneration advisor to obtain an opinion as to the appropriateness of its remuneration – and especially, on whether remuneration is in line with common practice and comparable. The Supervisory Board shall present the results of this review as part of its report to the AGM. Where appropriate, the Supervisory Board will prepare recommendations for adjustments to its remuneration, and will submit them to shareholders at the next AGM.

### Governance of Management Board remuneration

#### The role of the Supervisory Board

The Supervisory Board shall act in the Company's interests; accordingly, it shall ensure that Management Board remuneration is geared towards the Company's sustainable development (cf. section 87 of the AktG). The Supervisory Board decides on Management Board remuneration, monitors appropriateness, defines targets for determining variable remuneration, and decides on target achievement. During the years following determination of variable remuneration], the Supervisory Board shall review, within the framework of backtesting/penalty reviews, whether variable remuneration determined originally must be adjusted or reclaimed (clawback).

As part of examining appropriateness of Management Board remuneration, the Supervisory Board shall review whether the remuneration system for the Management Board (as well as the corresponding targets for Management Board members derived therefrom) is consistent with the Company's business and risk strategies, the objectives derived from these strategies, the corresponding risk management, as well as with the defined risk appetite and the corporate values. As further elements of this examination of appropriateness, a vertical comparison with the average remuneration of relevant employees and the top management level below the Management Board is to be carried out, as well as a horizontal comparison with the remuneration of management board members of comparable enterprises. These components reflect the orientation of Management Board remuneration

towards sustainable Company development, meaning that remuneration is aligned with the long-term interests of Aareal Bank's stakeholders.

When taking decisions concerning the structure of the remuneration system for the Management Board, the Supervisory Board shall take the views of Aareal Bank AG's relevant shareholders and of proxy advisors into account.

#### **The role of the Remuneration Control Committee**

The Remuneration Control Committee supports the Supervisory Board in its monitoring duties and prepares the plenary meeting's resolutions concerning remuneration. The Committee monitors the appropriateness of the structure of Management Board remuneration, proposes targets for variable remuneration and for target achievement at the end of the year, and also monitors the levels of target achievement during the course of each year. Moreover, the Committee assesses the effects of the remuneration systems on the Group's risk, capital and liquidity management. In the run-up to determining remuneration, in cooperation with the Audit Committee, it reviews whether there are any backtesting or penalty-triggering events which may result in a reduction of variable remuneration.

#### **The role of the Risk Committee**

The duties of the Risk Committee with regard to remuneration are unaffected by the assessment by the Remuneration Control Committee, as set out above. The Risk Committee verifies whether the incentives created by the remuneration system take the Company's risk, capital and liquidity structure into account, as well as the probability and timing of income.

#### **The role of the Audit Committee**

Circumstances where variable remuneration may be reduced may occur where Management Board members fail to fulfil any of their duties, or where they breach external or internal requirements. To the extent that any such events have occurred, these are identified in the reports prepared by Compliance, addressed to the Audit Committee as well as to the plenary meeting of the Supervisory Board. Internal conduct rules are also defined in a Code of Conduct which must be presented to the Audit Committee at least once a year.

#### **The role of the Annual General Meeting**

Under current legislation, Management Board remuneration may be submitted to the AGM for approval. Implementing the Second Shareholder Rights Directive in the German Public Limited Companies Act (AktG), as of the first ordinary Annual General Meeting following the 2020 financial year the AGM will address Management Board remuneration at least every four years as well as in the event of any material change to Management Board remuneration (say-on-pay).

### **Governance of staff remuneration**

#### **The role of the Management Board**

The Management Board is responsible for structuring the remuneration system for employees. As an element of appropriate and effective risk management, staff remuneration is monitored as to whether it is consistent with the corporate and risk culture, and with Aareal Bank's risk appetite. Especially with respect to the remuneration of material risk takers, the Management Board will take care to adjust remuneration parameters to such employees' influence on the Bank's risk exposure.

#### **The role of the Supervisory Board/the Remuneration Control Committee/ the Risk Committee**

The Supervisory Board and its Remuneration Control Committee monitor the structure of staff remuneration. In this context, the Remuneration Control Committee also assesses the criteria for, and the actual selection of, Aareal Bank Group's material risk takers. Together with the Risk Committee, and in line with the rules for Management Board remuneration, the Remuneration Control Committee monitors whether the remuneration system for employees is consistent with the Company's business and risk strategies, the objectives derived from these strategies, its risk appetite and the risk management.

#### **Further information on the Supervisory Board and its committees**

The composition and responsibilities of the Supervisory Board committees, and of the plenary meeting, are described in the Corporate Governance Statement/the Corporate Governance Report and in the Notes.



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The Supervisory Board presents the remuneration-related activities of its plenary meetings and of its committees as part of its report to the AGM. This report also provides details regarding the number of meetings, and on the participation of the members of the committees and the Supervisory Board.

### **The role of the Remuneration Officer**

Following consultation of the Supervisory Board, the Management Board of Aareal Bank AG shall appoint a Remuneration Officer in order to ensure appropriate, sustained and effective monitoring of staff remuneration. Aareal Bank has appointed a Remuneration Officer, to carry out duties in accordance with section 24 of the InstVergV. These duties include supporting the Supervisory Board and the Remuneration Control Committee in structuring and monitoring the remuneration system. The Remuneration Officer is obliged to respond to queries of the Remuneration Control Committee's Chairman.

The Remuneration Officer reports on the appropriate structure of the remuneration systems for employees in the form of a Remuneration Report at least once a year. Due to the responsibility of monitoring the appropriateness of the remuneration systems on a continuing basis, the Remuneration Officer is being included in the conceptual new drafting (and future development), as well as in the application of the remuneration systems. In particular, the Remuneration Officer plays an active part in the process for the determination of the total amount available for variable remuneration, the annual review of penalty rules, the regular (at least spot checks) review of appropriate compliance structures, the monitoring of the hedging ban (and potential violations), the drafting of the annual remuneration report (pursuant to section 16 of the InstVergV in connection with Article 450 of the CRR) as well as the review of the risk taker analysis.

### **Involvement of external remuneration advisors**

As a matter of principle, the executive bodies of Aareal Bank decide upon remuneration themselves; they also come to an independent assessment of appropriateness. Especially for the purpose of examining whether remuneration is in line with common practice, compared with other companies, Aareal Bank retains external remuneration advisors.

## **Takeover Disclosures in Accordance with Section 289a of the German Commercial Code (HGB)**

### **Composition of subscribed capital, and rights and obligations attached to shares**

The composition of Aareal Bank AG's subscribed capital is shown in the Note "Equity" to the consolidated financial statements. Each share casts one vote at a General Meeting. There are no shares with special rights granting supervisory powers to any shareholder or shareholder group. The Company currently does not hold any treasury shares, which would not be entitled to vote.

### **Restrictions affecting voting rights or the transfer of shares**

The transfer and exercise of voting rights is governed exclusively by legal restrictions. Voting rights are not limited to a certain number of shares, or of votes. All shareholders who have registered to attend a General Meeting in good time, and who have provided the Company with evidence of their shareholding and their right to vote, are entitled to attend the General Meeting, and to exercise their voting rights from all shares held and so registered. The exercise of voting rights from the shares concerned is precluded by law in the cases where section 136 of the German Public Limited Companies Act (Aktiengesetz – "AktG") applies. Where the Company holds treasury shares, section 71b of the AktG prohibits the exercise of rights vested in such shares. We are not aware of any other restrictions affecting voting rights or the transfer of shares.

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## **Shareholdings exceeding 10% of voting rights**

Details regarding any shareholdings exceeding 10% of voting rights are provided in the Note “Disclosures pursuant to section 160 (1) no. 8 of the AktG”.

## **Shares with special rights granting the holder supervisory powers**

Aareal Bank AG's Memorandum and Articles of Association do not grant any shareholder the right to nominate members to the Supervisory Board, nor are there any other shares with special rights granting the holder supervisory powers.

## **Type of control of voting rights regarding shares held by employees with their rights of control not being directly exercised**

There are no Aareal Bank AG shares held by employees where the rights of control cannot be directly exercised.

## **Statutory provisions, and provisions in the Memorandum and Articles of Association regarding the appointment and removal of members of the Management Board, and regarding amendments to the Memorandum and Articles of Association**

The appointment and removal of members of the Management Board of Aareal Bank AG is carried out in accordance with sections 84 and 85 of the AktG and Article 7 of the Memorandum and Articles of Association, according to which the Management Board must have a minimum of two members. The Supervisory Board shall appoint the Members of the Management Board and determine their number. The Supervisory Board may appoint deputy members, and may appoint one member of the Management Board to be the Chairman of the Management Board. The members of the Management Board are appointed for a maximum term of five years. This term of office may be renewed or extended for a maximum of five years in each case.

Pursuant to section 179 of the AktG, the Memorandum and Articles of Association may be amended by way of resolution passed by the General Meeting. Resolutions of the General Meeting regarding amendments to the Memorandum and Articles of Association are passed by a simple majority of the votes cast, or – to the extent permitted by law – by the majority of the issued share capital present at the Meeting. In accordance with section 181 (3) of the AktG, such amendments become effective upon their entry in the Commercial Register. In the event of a capital change, the Supervisory Board is authorised to modify the wording of the Articles of Association in line with the amount of the capital change (Article 5 (7) of the Memorandum and Articles of Association).

## **Authorisation of the Management Board to issue or repurchase shares**

### **Authorised capital**

The Annual General Meeting held on 31 May 2017 resolved to authorise the Management Board to increase, on one or more occasions, the Company's share capital, subject to the approval of the Supervisory Board, by up to a maximum total amount of € 89,785,830 by issuance of new shares for contribution in cash or in kind; the Management Board is also authorised, within defined limits, to disapply pre-emptive rights, given the fulfilment of certain conditions. This authorisation will expire on 30 May 2022. When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20% of the Company's share capital – including treasury shares and any shares issued during the term of this authorisation, under the authorisation under agenda item no. 6 of the Annual General Meeting held on 21 May 2014. The authorised capital has not been utilised to date.

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## Conditional capital

Based on a resolution passed by the Annual General Meeting on 22 May 2019, the Management Board was authorised to issue, on one or more occasions until 21 May 2024, profit-participation certificates with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of up to € 900,000,000. The profit-participation certificates must be structured in such a way that the funds paid upon issuance are eligible as regulatory capital pursuant to the legal regulations applicable as at the time of issuance. Profit-participation certificates and other hybrid promissory note loans to be issued according to this authorisation shall be connected with conversion rights for the holder, entitling or compelling, in accordance with their respective conditions, the holder to purchase Company shares. Conversion rights or obligations may only be issued or created for no-par value bearer shares of the Company with a proportionate amount of the Company's share capital of € 71,828,664.00. The sum of shares to be issued so as to service conversion or option rights or conversion obligations from profit-participation certificates or hybrid promissory note loans issued pursuant to this authorisation, including shares issued during validity of this authorisation as a result of another authorisation (especially from the Authorised Capital 2017), may not exceed an amount of € 71,828,664.00 (which equals approx. 40% of the current share capital). Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

Accordingly, the Company's share capital is subject to a conditional capital increase not exceeding € 71,828,664.00 by issuance of up to 23,942,888 new no-par value bearer shares ("Conditional Capital 2019"). The purpose of the conditional capital increase is to grant shares to holders or creditors of convertible bonds issued in accordance with the aforementioned authorisation. The new no-par value bearer shares may only be issued at a conversion price in line with the resolution passed by the General Meeting on 22 May 2019. The conditional capital increase shall only be carried out insofar as conversion rights are exercised or as conversion obligations from such convertible bonds are fulfilled or as the Company makes use of alternative performance and insofar as no cash compensation is granted or treasury shares are used to service the rights. The new shares shall be entitled to a share in the profits from the beginning of the financial year in which they come into existence through the exercise of conversion rights or the fulfilment of conversion obligations. The Management Board is authorised to determine the details of the conditional capital increase. The Management Board is also authorised to determine the further contents of share rights and the terms governing the issuance of shares, subject to the approval of the Supervisory Board.

## Authorisation to purchase treasury shares

The General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) no. 7 of the AktG, to purchase and sell treasury shares for the purposes of securities trading, at a price not falling below or exceeding the average closing price of the Company's share in Xetra trading (or a comparable successor system) during the three trading days on the Frankfurt Stock Exchange prior to the relevant transaction by more than 10%. This authorisation expires on 19 May 2020. The volume of shares acquired for this purpose must not exceed 5% of the share capital of Aareal Bank AG at the end of any given day.

Furthermore, the General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) no. 8 of the AktG, to purchase treasury shares with a volume of up to 10% of the issued share capital for purposes other than securities trading. This authorisation expires on 19 May 2020. Such purchases may be effected via stock exchanges or public purchase offers made to all shareholders, taking into account the prices as specified in the respective Annual General Meeting's resolution, which are in turn based on the Company's stock exchange share price. This authorisation may be exercised, in full or in part, on one or more occasions.

Subject to the approval of the Supervisory Board, the shares acquired under this or an earlier authorisation may be sold outside stock exchanges and without an offer to all shareholders, thereby excluding shareholders' pre-emptive rights, provided that the shares sold do not exceed the threshold value of 10% of the Company's share capital and that the issue price is not significantly lower than the stock exchange price, or if the sale of such shares is made against contribution in kind, or if the shares are given to the holders of conversion or option rights, even if they had been issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without this withdrawal or its implementation requiring a further resolution by the Annual General Meeting.

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The Management Board was also authorised to effect the acquisition of treasury shares by using put or call options. However, any and all share purchases involving the use of derivatives shall be limited to a maximum threshold value of 5% of the Company's share capital. In addition, any acquisition of shares shall count towards the 10% threshold for the authorisation for the acquisition of treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

### **Material agreements which are subject to change of control clauses triggered in the event of a takeover offer**

There are no material agreements which are subject to change of control clauses triggered in the event of a takeover offer. Any public offers to acquire the Company's shares are governed exclusively by the law (including the provisions of the German Securities Acquisition and Takeover Act), and the Memorandum and Articles of Association.

### **Compensation agreements entered into with members of the Management Board or employees in the event of a takeover offer**

For details regarding compensation agreements entered into with members of the Management Board or employees in the event of a takeover bid, please refer to the Remuneration Report.

### **Combined Non-Financial Statement**

The Combined Separate Non-Financial Report pursuant to sections 289b (3) and 315b (3) of the HGB has been published on the Company's website, on [www.aareal-bank.com/en/responsibility/reporting-on-our-progress/](http://www.aareal-bank.com/en/responsibility/reporting-on-our-progress/).

### **Corporate Governance Statement**

Since Aareal Bank AG is the only listed Group entity, and also the Group's parent undertaking, only one Corporate Governance Statement will be issued.

The full Corporate Governance Statement pursuant to sections 289f and 315d of the HGB is publicly available on the Company's website (<https://www.aareal-bank.com/en/about-us/corporate-governance/>), and in the "Transparency" section of the Group Annual Report.

## Annual Financial Statements

### Income Statement of Aareal Bank AG for the period from 1 January to 31 December 2019

	2019	2018
€ mn		
<b>Expenses</b>		
<b>Interest expenses</b>	<b>695.8</b>	<b>653.7</b>
including positive interest from lending and money-market transactions	-14.6	[-8.7]
Commission expenses	19.0	29.3
<b>General administrative expenses</b>		
a) Staff expenses		
aa) Wages and salaries	112.6	113.8
ab) Social security contributions, pensions and other employee benefits	42.1	38.3
	154.7	152.1
including for pensions	29.5	[26.4]
b) Other administrative expenses	141.2	151.8
	<b>295.9</b>	<b>303.9</b>
Amortisation, depreciation and write-downs of intangible and tangible fixed assets	5.8	4.3
Other operating expenses	23.4	24.3
Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions	198.4	124.3
Expenses for assumption of losses	12.7	0.0
Income taxes	-8.4	37.0
Other taxes not reported under other operating expenses	0.1	0.1
Net income	119.7	125.7
<b>Total expenses</b>	<b>1,362.4</b>	<b>1,302.6</b>
Net income	119.7	125.7
Profit carried forward from the previous year	-	-
<b>Net retained profit</b>	<b>119.7</b>	<b>125.7</b>

	2019	2018
€ mn		
<b>Income</b>		
<b>Interest income from</b>		
a) Lending and money-market transactions	912.3	883.3
including negative interest from lending and money-market transactions	-11.6	[-9.5]
b) Fixed-income securities and debt register claims	189.7	217.0
	<b>1,102.0</b>	<b>1,100.3</b>
<b>Current income from</b>		
a) Participating interests	-	0.1
b) Interests in affiliated companies	63.0	100.7
	<b>63.0</b>	<b>100.8</b>
Income from profit pools, profit transfer agreements or partial profit transfer agreements	34.0	27.2
Commission income	32.4	30.2
Income from write-ups on equity investments, interests in affiliated companies, and securities held as fixed assets	70.5	3.2
Other operating income	23.2	40.9
Income from amounts released from the fund for general banking risks	-	-
Extraordinary income	37.3	-
<b>Total income</b>	<b>1,362.4</b>	<b>1,302.6</b>

## Balance Sheet of Aareal Bank AG as at 31 December 2019

	2019	2018
€ mn		
<b>Assets</b>		
<b>Cash funds</b>		
a) Cash on hand	0.0	0.0
b) Balances with central banks	1,494.1	1,160.0
<i>including: with Deutsche Bundesbank</i>	1,493.7	[1,154.3]
	<b>1,494.1</b>	<b>1,160.0</b>
<b>Loans and advances to banks</b>		
a) Loans secured by charges on real property	-	4.2
b) Other loans and advances	1,425.9	816.8
<i>including: payable on demand</i>	1,121.1	[545.6]
	<b>1,425.9</b>	<b>821.0</b>
<b>Loans and advances to customers</b>		
a) Loans secured by charges on real property	22,036.4	21,589.7
b) Loans to local authorities	1,699.3	1,354.7
c) Other loans and advances	2,783.5	4,278.7
	<b>26,519.2</b>	<b>27,223.1</b>
<b>Debt and other fixed-income securities</b>		
a) Bonds and notes		
aa) Public-sector issuers	5,460.3	6,162.9
<i>including: with Deutsche Bundesbank</i>	5,233.5	[5,929.6]
ab) Other issuers	512.3	371.3
<i>including: with Deutsche Bundesbank</i>	462.0	[269.9]
	5,972.6	6,534.2
b) Own bonds	965.9	348.5
<i>Nominal amount:</i>	963.9	[347.0]
	<b>6,938.5</b>	<b>6,882.7</b>
<b>Equities and other non-fixed income securities</b>	<b>100.1</b>	<b>100.7</b>
<b>Participating interests</b>	<b>7.4</b>	<b>11.6</b>
<b>Interests in affiliated companies</b>	<b>1,634.2</b>	<b>1,362.0</b>
<i>including: interests in banks</i>	9.9	[9.6]
<b>Trust assets</b>	<b>22.9</b>	<b>35.9</b>
<i>including: trustee loans</i>	21.3	[34.4]
<b>Intangible assets</b>		
a) Internally generated industrial property rights and similar rights and assets	4.9	4.7
b) Purchased concessions, industrial property rights and similar rights and assets, as well as licences in such rights and assets	7.8	2.7
	<b>12.7</b>	<b>7.4</b>
<b>Tangible fixed assets</b>	<b>10.0</b>	<b>12.3</b>
<b>Other assets</b>	<b>212.3</b>	<b>527.0</b>
<b>Prepaid expenses</b>		
a) From new issues and lending	182.0	181.6
b) Other	29.0	37.1
	<b>211.0</b>	<b>218.7</b>
<b>Deferred tax assets</b>	<b>302.4</b>	<b>259.1</b>
<b>Total assets</b>	<b>38,890.7</b>	<b>38,621.5</b>

		2019	2018
€ mn			
<b>Equity and liabilities</b>			
<b>Liabilities to banks</b>			
a) Outstanding registered mortgage Pfandbriefe	391.4		439.9
b) Outstanding registered public-sector Pfandbriefe	136.8		114.8
c) Other liabilities	1,155.5		1,362.4
		<b>1,683.7</b>	<b>1,917.1</b>
<i>including: payable on demand</i>	<i>709.7</i>		<i>[721.8]</i>
<b>Liabilities to customers</b>			
a) Outstanding registered mortgage Pfandbriefe	3,353.2		4,116.1
b) Outstanding registered public-sector Pfandbriefe	1,971.5		1,527.2
c) Other liabilities	17,421.9		18,248.8
		<b>22,746.6</b>	<b>23,892.1</b>
<i>including: payable on demand</i>	<i>8,516.2</i>		<i>[8,986.5]</i>
<b>Certificated liabilities</b>			
Bonds issued			
a) Mortgage bonds	7,576.3		6,127.4
b) Public-sector Pfandbriefe	15.0		15.0
c) Other debt securities	2,839.4		2,807.2
	10,430.7		8,949.6
		<b>10,430.7</b>	<b>8,949.6</b>
<b>Trust liabilities</b>		<b>22.9</b>	<b>35.9</b>
<i>including: trustee loans</i>	<i>21.3</i>		<i>[34.4]</i>
<b>Other liabilities</b>		<b>376.1</b>	<b>139.6</b>
<b>Deferred income</b>			
a) From new issues and lending	84.5		79.6
b) Other	51.7		52.0
		<b>136.2</b>	<b>131.6</b>
<b>Provisions</b>			
a) Provisions for pensions and similar obligations	212.9		193.8
b) Tax provisions	33.0		29.2
c) Other provisions	98.5		99.5
		<b>344.4</b>	<b>322.5</b>
<b>Subordinated liabilities</b>		<b>915.3</b>	<b>992.3</b>
<i>including: maturing within two years</i>	<i>106.0</i>		<i>[94.0]</i>
<b>Additional Tier 1 capital instruments</b>		<b>315.4</b>	<b>315.4</b>
<b>Fund for general banking risks</b>		<b>167.6</b>	<b>167.6</b>
<b>Equity</b>			
a) Subscribed capital	179.6		179.6
b) Capital reserve	727.8		727.8
c) Retained earnings			
ca) Legal reserve	4.5		4.5
cb) Other retained earnings	720.2		720.2
	724.7		724.7
d) Net retained profit	119.7		125.7
		<b>1,751.8</b>	<b>1,757.8</b>
<b>Total equity and liabilities</b>		<b>38,890.7</b>	<b>38,621.5</b>

		2019	2018
€ mn			
<b>Contingent liabilities</b>			
Liabilities from guarantees and indemnity agreements	47.1		45.8
		<b>47.1</b>	<b>45.8</b>
<b>Other commitments</b>			
Irrevocable loan commitments	2,236.4		1,734.5
		<b>2,236.4</b>	<b>1,734.5</b>

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## Notes

### Basis of Accounting

Aareal Bank AG is a public limited company incorporated under German law, with its registered office in Wiesbaden, Germany, and the parent company of Aareal Bank Group. It also prepares the consolidated financial statements majority of consolidated companies within the Group. It is registered under HRB 13 184 in the Commercial Register of the Wiesbaden local court.

The financial statements of Aareal Bank AG for the financial year ended on 31 December 2019 were prepared in accordance with the provisions – as applicable at the reporting date – of the German Commercial Code (Handelsgesetzbuch – "HGB"), the supplementary regulations of the German Public Limited Companies Act (Aktiengesetz – "AktG"), the German Accounting Directive for Banks and Financial Services Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – "RechKredV") and the German Pfandbrief Act (Pfandbriefgesetz – "PfandBG"). The reporting currency is the euro (€).

The Management Board approved the annual financial statements for publication on 2 March 2020; they will be published in the German Federal Gazette, alongside the consolidated financial statements.

### Accounting and Valuation Principles

#### (1) Cash funds

Cash funds include cash on hand and balances with central banks. Cash funds are accounted for at the notional amount.

#### (2) Loans and advances

Loans and advances to banks and customers are carried at amortised cost, including deferred interest. Premiums and discounts are shown under deferred items, in accordance with section 340e (2) of the HGB. Credit risks are accounted for by setting aside provisions in the amount of the expected loss, using prudent estimates. The proceeds from realisation are determined on the basis of the expected value of various possible scenarios. The portfolio-based valuation allowances are calculated using a formula-based procedure based on the following Basel III parameters used in the Advanced IRB Approach: expected loss given default (LGD) and probability of default (PD). With regard to exposures that were subject to a significant increase in default risk since the grant date, lifetime expected losses are recorded rather than the 12-month expected loss.

#### (3) Securities

Bonds and other fixed-income securities, as well as equities and other non-fixed income securities held as current assets, are measured strictly at the lower of cost or market value, as prescribed for current assets (strenges Niederstwertprinzip). Aareal Bank AG's current assets presently are composed exclusively of securities of the liquidity reserve. Bonds and other fixed-income securities that are intended to be held permanently, are carried at the lower of cost or market value; the carrying amount needs to be written down to the lower market value only if the impairment is permanent (gemildertes Niederstwertprinzip). Where the reasons for the write-down no longer apply, write-ups are made in accordance with section 253 (5) of the HGB.

#### (4) Participating interests, interests in affiliated companies, intangible assets and tangible assets

Participating interests and interests in affiliated companies are stated at cost or, in case of a presumably permanent impairment, at the lower fair value in accordance with section 253 of the HGB (gemildertes Niederstwertprinzip).

Tangible assets and purchased intangible assets are stated at cost less depreciation/amortisation. Write-downs are required in the event of impairments in value deemed to be other than temporary.



Office furniture and equipment items are depreciated using the straight-line method, applying the following depreciation periods:

	Depreciation period
IT equipment	3 to 5 years
Other office furniture and equipment	5 to 13 years
Vehicle fleet	6 years
Tenant's improvements	10 years

Intangible assets comprise purchased as well as self-developed software, which is amortised over a useful life of three to five years.

The option to capitalise internally generated intangible assets pursuant to section 248 (2) of the HGB was exercised. Pursuant to section 255 (2) sentence 3 of the HGB, the calculation of manufacturing costs incorporates general administrative costs as well as expenses for social facilities provided by the Company, voluntary social benefits, and company retirement provisions. Internally generated intangible assets are amortised on a straight-line basis over a period of five years from the date they are ready for operation.

Where the reasons for the write-down no longer apply, write-ups are recognised for participating interests, interests in affiliated companies, intangible assets and tangible assets in accordance with section 253 (5) of the HGB. To the extent that land and buildings were acquired to salvage loans, and have been in the possession of the Bank for more than five years, these are reported under tangible fixed assets. Additions of low-value commercial goods ("geringwertige Wirtschaftsgüter") of not more than € 250 are recognised through profit or loss.

The option to disclose a net amount, pursuant to section 340c (2) of the HGB, has been exercised.

## **(5) Trust assets and trust liabilities**

These balance sheet items include assets and liabilities that the Bank holds on its own behalf, but for the account of third parties. These items are measured at amortised cost.

## **(6) Other assets**

Other assets are reported at nominal amount. In case of reduced recoverability, impairment losses down to the lower of the exchange or market price, or the expected value, are recorded pursuant to section 253 (4) of the HGB.

## **(7) Deferred taxes**

If there are differences between the book value of assets, liabilities, deferred income and prepaid expenses and their related tax bases which are expected to be reversed in later financial years, any resulting net tax burden is recognised as a deferred tax liability and any resulting net tax benefit is recognised as a deferred tax asset, in accordance with section 274 of the HGB. Tax loss carry-forwards are taken into account in the calculation of deferred tax assets, based on the level of the potential losses to be offset within the next five years. Deferred taxes are measured using the company- and country-specific tax rates expected to apply at the time of the realisation of temporary differences and the offsetting of loss carryforwards. The Bank reports deferred taxes on a net basis.

## **(8) Liabilities**

Liabilities are shown on the balance sheet at the settlement amount. The difference between the settlement amount and the lower initial book value of liabilities is recognised under deferred items, and amortised over the term of the liability.

## **(9) Provisions**

Provisions are recognised in the amount of the required settlement amount, as determined based on prudent commercial judgement. Pursuant to section 253 (2) sentence 1 of the HGB, provisions with

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a remaining term of more than one year have to be discounted using the average market interest rate applicable for their remaining term; the average market interest rate for provisions for retirement benefit obligations is based on the rates of the past ten years, while that for other provisions is based on the rates of the past seven years.

Provisions for pensions and similar obligations are determined based on actuarial principles. Provisions for pensions are recognised at the settlement amount taking into account future wage, salary and pension trends and applying the average market interest rate applicable for an assumed remaining term of 15 years as disclosed by Deutsche Bundesbank, except where the applicable remaining term of the respective pension plan is shorter. In accordance with section 240 (2) of the HGB, pension obligations are generally determined based on inventory records established as at the balance sheet date. Pursuant to section 241 (3) of the HGB, the relevant group of eligible persons may also be recorded as at a date within the last three months prior to, or within the first two months after, the balance sheet date, provided that the pension obligations may be measured properly as at the balance sheet date. This is ensured by using forecast interest rates. Reference is made to the Notes to the balance sheet. Provisions for taxes and other provisions have been set aside for existing legal or constructive obligations in the settlement amount, as required by prudent commercial judgement.

#### **(10) Additional Tier 1 capital instruments**

The instruments issued are classified as liabilities and are recognised at their settlement amount. The interest expense is accrued in the amount of the expected payments.

#### **(11) Fund for general banking risks**

The fund for general banking risks was recognised in accordance with section 340g of the HGB and is intended as a protection against general banking risks to the extent that this is necessary based on prudent business judgement given the specific risks of the business activities of banks. Expenses for additions to this special item or income from the reversal of the special item were not incurred in the year under review.

#### **(12) Currency translation**

Currency translation complies with the principles set out in sections 256a and 340h of the HGB.

Assets and liabilities denominated in foreign currency as well as pending spot transactions are translated using the middle spot rate (ECB reference middle rate) applicable on the recognition date.

Assets and liabilities denominated in foreign currency or forward foreign exchange transactions are classified as specific cover and are measured at the middle spot rate (ECB reference middle rate) on the balance sheet date. Income and expenses from currency translations are recognised through profit or loss under other operating income and expenses.

The Bank decomposes foreign exchange forward transactions which are used to hedge interest-bearing balance sheet items into an agreed spot base and the swap rate, recognising a deferred asset or liability equivalent to the net aggregate difference between the spot base and the same currency's exchange rates prevailing on the reporting date. Forward premiums or discounts are amortised in net interest income over the term of the transaction.

#### **(13) Trading portfolio**

The Bank held no financial instruments for trading as at the balance sheet date. The Bank-internal criteria for the inclusion of financial instruments into the trading portfolio were not changed during the reporting year.

#### **(14) Hedging relationships**

The Bank establishes hedging relationships within the meaning of section 254 of the HGB. Accordingly, fixed-income securities of the liquidity reserve in the amount of € 3,176.7 million (2018: € 3,656.3 million) are hedged against changes in value attributable to interest rate risk by means of interest rate hedges with a nominal amount of € 3,089.4 million (2018: € 3,547.9 million), on the basis of so-called "micro hedges". In this context, the underlying transaction and the hedge generally are acquired within the framework of so-called "asset swap packages", i.e. they are so-called "perfect hedges" where all value-affecting factors between the hedged portion of the underlying

transaction substantially correspond to the hedging portion of the hedge. The prospective effectiveness of the hedging relationship, which refers to the period until the security's final maturity, is proven, based on a sensitivity analysis in conjunction with the so-called "Critical Terms Match Method".

The Bank continues to establish hedging relationships between repurchased own bonds in a nominal amount of €965.9 million (2018: €348.5 million) and the corresponding securitised liabilities.

This is presented in the financial statements using the so-called "Net Hedge Presentation Method" (Einfrierungsmethode). Under this method, the cumulative change in the value of the underlying transaction is determined on the basis of the hedged risk, and compared to the changes in the value of the hedge. The hedged risk amounts to € 190.5 million (2018: € 312.5 million) and corresponds to the cumulative increase of the fair value of assets since inception of the hedging relationship. This net increase is not shown in the income statement on a net basis, after including hedge transactions. Any previously existing ineffectiveness based on the hedged risk is reflected in a provision for hedging relationships. The changes in value attributable to the hedged risk are reflected on a portfolio basis, in the form of a write-down on the security concerned.

### **(15) Fair value measurement of interest rate instruments of the banking book**

In addition, the Bank uses derivative financial instruments of the banking book (non-trading book), above all interest rate swaps, for the purpose of controlling interest rate risk (interest spread risk) as part of the overall management of the Bank. In accordance with HGB, these instruments represent "pending transactions" which are not recognised in the balance sheet. They form a "hedging relationship", together with the recognised interest-bearing assets and liabilities of the banking book. In accordance with IDW RS BFA 3, this hedging relationship has to be reviewed as to whether losses are anticipated, taking into account expected expenses required for funding, risk management and administration in relation to managing the banking book. Currently, the Bank has two equally suitable methods available to determine provisions for anticipated losses: the P&L based approach referring to certain time periods, and the (static) present value method. The Bank uses the present value method. Under this method, a provision has to be recognised when the book value of the banking book exceeds the present value of the banking book, i.e. if there are net unrealised losses in the banking book. The present value is derived from the cash flows of the financial instruments included in the banking book, discounted to the balance sheet date. Potential future risk costs are considered by adjusting the applicable interest rate used for the discounting of cash flows. The administrative expenses relating to the banking book are derived from cost accounting and deducted on a lump-sum basis. No provision for anticipated losses had been recognised as at the balance sheet date, since the present value of the banking book is higher than the book value as at 31 December 2019.

### **(16) Derivatives**

Derivative financial instruments are considered pending transactions, and are therefore generally not recorded in the balance sheet.

Exchange-traded derivatives are measured at their quoted market price. The market price of over-the-counter (OTC) derivatives is determined using standard valuation models commonly accepted in the financial industry, such as the present value technique and option pricing models. The fair value of foreign exchange forwards is generally based on current forward exchange rates.

Acquired as well as issued structured products are generally accounted for as groups of uniform assets and liabilities in accordance with IDW RS HFA 22.

### **(17) Interest income and expense**

Negative interest from financial assets and positive interest from financial liabilities are disclosed separately under interest income and expenses as a 'thereof' position. These assets and liabilities are deposits and borrowings, as well as money market and securities repurchase transactions.

## (18) Acquisition of the split-off banking operations of the former Düsseldorf

In the course of the first half of 2019, the split-off banking operations of former Düsseldorf were merged into Aareal Bank AG, with effect from 2 January 2019. The income statement includes the income and expenses of the split-off banking operations of former Düsseldorf from 2 January 2019. The previous year's figures do not include income and expenses or assets and liabilities from former Düsseldorf's banking operations; therefore, the respective financial statements and indicators for the financial position and financial performance of Aareal Bank AG for the financial years 2018 and 2019 are comparable only to a limited degree.

The assets and liabilities of the split-off banking operations of the former Düsseldorf were recognised at cost within the meaning of section 253 (1) of the HGB, determined using the book values reported in the closing balance sheet of the transferring legal entity in accordance with section 24 of the German Transformation Act (Umwandlungsgesetz – "UmwG"). The profit resulting from the difference between the book value of the absorbed shares and the book value of the acquired net assets (€ 37.3 million) is recognised as extraordinary income.

The assumption of the split-off banking operations resulted in an increase of total assets of Aareal Bank AG as at the split-off date by approx. € 2.1 billion. The major effects from the assumption of the split-off banking operations were an increase in loans and advances to customers and banks (€ 0.7 billion and € 0.4 billion, respectively) as well as the balance of debt and other fixed-income securities (€ 0.9 billion). On the equity and liabilities side of the balance sheet, liabilities to banks and customers increased by € 0.1 billion and € 1.8 billion, respectively. The increase in assets and liabilities also led to an increase of interest income and expenses. The result arising on the sale of bonds amounted to € +48.9 million.

The former Düsseldorf operates under the name "DHB Verwaltungsgesellschaft AG" after the split-off of the banking operations. Its banking licence has lapsed.

## Notes to the Income Statement

### (19) Income by geographical segment

The aggregate of (i) interest income, (ii) current income on equities and other non-fixed income securities, and on participating interests and interests in affiliated companies, (iii) commission income and (iv) other operating income is broken down by the following regions, in accordance with section 34 of the RechKredV.

€ mn	2019	2018
Germany	220.0	349.1
Rest of Europe, North America, Asia/Pacific	1,000.6	923.1
<b>Total</b>	<b>1,220.6</b>	<b>1,272.2</b>

### (20) Administration and intermediation services rendered to third parties

Administration and intermediation services rendered to third parties concerned the administration and intermediation of loans and trust assets.

### (21) Other operating income and expenses

Other operating income of € 23.2 million (2018: € 40.9 million) includes income from the reversal of provisions in the amount of € 12.5 million (2018: € 25.3 million) as well as € 5.1 million (2018: € 8.1 million) in income from tax refunds (including interest).

Other operating expenses of € 23.4 million (2018: € 24.3 million) include additions to provisions in the amount of € 7.6 million (2018: € 0.5 million), expenses for subsidiaries in the amount of € 3.7 million (2018: € 5.0 million) as well as currency translation expenses in the amount of € 2.8 million (2018: € 5.9 million). In addition, the item includes expenses in the amount of € 3.8 million (2018:

€ 11.1 million) from unwinding of discounts, after offsetting with income from plan assets used for pension obligations pursuant to section 246 (2) sentence 2 of the HGB.

## (22) Extraordinary income and expenses

In connection with the split-off of the banking operations of former Düsseldorfer Hypothekenbank AG to Aareal Bank AG, extraordinary income is reported in the amount of € 37.3 million.

In the previous year, there were no extraordinary income or expenses.

## (23) Net income taxes

The net income tax position amounts to an income of € 8.4 million (2018: expense of € 37.0 million), of which expenses of € 34.4 million (2018: € 14.6 million) included in current taxes were payable in Germany: this figure comprises € 17.5 million (2018: € 30.6 million) in corporation tax and solidarity surcharge and € 17.6 million (2018: € 31.2 million) in trade tax payable for the current year, as well as € 0.7 million (2018: € 47.1 million) in tax income for previous years. The net income tax position also includes € 38.0 million (2018: € 18.9 million) in income from the increase of German deferred tax assets as well as € 4.8 million (2018: expense of € 3.4 million) in income from the Bank's foreign branch offices.

The tax reconciliation is used to determine why the tax expense (current taxes and deferred taxes) reported in the income statement differs from the expense calculated using the expected tax rate. The expected tax rate of 31.7% (2018: 31.7%), including a weighted trade tax rate of assessment of 453%, comprises trade taxes (15.9%), corporation taxes (15.0%) and the solidarity surcharge (0.825%; 5.5% of corporation tax).

€ mn	2019	2018
Income before income taxes	111.3	162.7
Expected income tax expenses; tax rate: 31.7% (2018: 31.7%)	35.3	51.6
<b>Reconciliation</b>		
Different foreign tax burden	-2.4	14.2
Tax attributable to tax-exempt income	-66.0	-39.0
Tax attributable to non-deductible expenses	21.0	6.4
Remeasurement of deferred taxes	-	-
Prior-period actual taxes	2.6	3.3
Effect of changes in tax rates	-	-
Other tax effects	1.1	0.5
Reported income tax expenses	-8.4	37.0
Effective tax rate (%)	-7.5	22.7

## (24) Prohibition of distribution

A total amount of € 313.5 million (2018: € 268.4 million) in profits is subject to a prohibition of distribution, pursuant to section 268 (8) of the HGB, of which € 302.4 million (2018: € 259.1 million) is attributable to the balance resulting from recognised deferred tax assets and recognised deferred tax liabilities. A prohibition of distribution applies to a net amount of € 6.2 million (2018: € 4.6 million) (after fair-value netting of assets), pursuant to section 246 (2) sentence 2 of the HGB. Moreover, a prohibition of distribution pursuant to section 248 (2) sentence 1 of the HGB is included for internally generated intangible assets in the amount of € 4.9 million, (2018: € 4.7 million).

In addition, a prohibition of distribution applies to an amount of € 40.4 million (2018: € 41.6 million) pursuant to section 253 (6) sentence 1 of the HGB regarding the difference between (a) the amount to be recognised for provisions for pensions according to the average market interest rate of the previous ten business years and (b) the amount to be recognised for provisions for pensions according to the average market interest rate of the previous seven business years.

The prohibition of distribution therefore totals € 353.9 million (2018: € 310.0 million) during the year under review pursuant to HGB regulations.

## Notes to the Balance Sheet

### (25) Securities negotiable at a stock exchange

The following table is a breakdown of securities negotiable at a stock exchange included in the balance sheet line items, including accrued interest.

€ mn	Listed	Unlisted	Listed	Unlisted
	31 Dec 2019	31 Dec 2019	31 Dec 2018	31 Dec 2018
Debt and other fixed-income securities	6,938.5	0.0	6,882.7	0.0
Equities and other non-fixed income securities	0.0	0.0	0.0	0.0
Participating interests	-	-	-	-
Interests in affiliated companies	-	309.8	-	308.4

Hedging relationships as defined by section 254 of the HGB have been created with respect to negotiable securities in an aggregate amount of € 4,142.6 million (2018: € 4,004.8 million).

Bonds and notes, including own bonds, of € 6,938.5 million (2018: € 6,882.7 million) (including accrued interest) reported under debt and other fixed-income securities comprise € 277.1 million (2018: € 334.7 million) in securities which are not eligible as collateral with Deutsche Bundesbank. Of that amount, € 117.9 million (2018: € 112.2 million) relate to sovereign foreign-currency bonds, which are eligible for securities lending.

The total amount of securities negotiable at a stock exchange reported in the balance sheet item "Interests in affiliated companies" consists of interests in Aareon AG, Aareal Beteiligungen AG, Aareal First Financial Solutions AG, Westdeutsche Immobilien Servicing AG, Deutsche Bau- und Grundstücks-Aktiengesellschaft, and DHB Verwaltungs AG.

### (26) Investment fund units

The following table is an analysis of investment fund assets, where more than 10% of the fund units are held.

€ mn	Book value	Market value	Book value	Market value
	31 Dec 2019	31 Dec 2019	31 Dec 2018	31 Dec 2018
DBB INKA	100.1	100.1	100.7	100.7
Aareal Altersvorsorge BV 97	61.3	61.3	52.6	52.6
<b>Total</b>	<b>161.4</b>	<b>161.4</b>	<b>153.3</b>	<b>153.3</b>

DBB INKA is an investment fund as defined under German law (Sondervermögen) which invests in assets permitted under the German Investment Act (Investmentgesetz – "InvG"), observing the principle of risk diversification. The right to redeem fund units on a daily basis is unrestricted.

Aareal Altersvorsorge BV 97 is an investment fund as defined under German law (Sondervermögen), which invests in assets permitted under the fund's investment policy, observing the principle of risk diversification. This investment fund is protected from access by all creditors, and is only intended to settle liabilities from retirement benefit obligations vis-à-vis employees.

The value of investment fund units as defined by sections 168 and 278 of the German Capital Investment Act (Kapitalanlagegesetzbuch – "KAGB") was € 161.4 million (2018: € 153.3 million). During the financial year under review, no distributions were made under the fund.

**(27) Movements in fixed assets**

The changes in fixed assets are presented in the fixed assets development schedule shown below.

The values shown for debt and other fixed-income securities include additions and disposals, as well as changes in inventory due to the amortisation of premiums and discounts (excluding accrued interest).

€ mn	Debt and other fixed-income securities	Participating interests	Interests in affiliated companies	Intangible assets	Tangible fixed assets	
					Office furniture and equipment	Land and buildings
<b>Cost</b>						
<b>As at 1 Jan 2019</b>	<b>2,177.3</b>	<b>12.5</b>	<b>1,384.8</b>	<b>46.8</b>	<b>36.8</b>	<b>0.1</b>
Addition						
Merger/split	-	-	153.2	-	-	-
Additions	611.0	0.2	493.6	8.8	0.8	-
Derecognition						
Merger/split	-	-	261.7	-	-	-
Disposals	626.0	-	73.2	2.5	1.1	-
Changes in inventory/transfers	235.0	-	-	-	-	-
<b>As at 31 Dec 2019</b>	<b>2,397.3</b>	<b>12.7</b>	<b>1,696.7</b>	<b>53.1</b>	<b>36.5</b>	<b>0.1</b>
<b>Depreciation, amortisation and write-downs</b>						
<b>As at 1 Jan 2019</b>	<b>0.0</b>	<b>0.9</b>	<b>22.8</b>	<b>39.4</b>	<b>24.6</b>	<b>0.0</b>
Addition <sup>1)</sup>						
Merger/split	-	-	4.4	-	-	-
Additions	-	-	-	-	-	-
Depreciation and amortisation	-	-	-	1.8	-	-
Write-downs	-	4.4	35.3	1.1	2.9	-
Derecognition						
Merger/split	-	-	-	-	-	-
Disposals	-	-	-	1.9	0.9	-
Transfers	-	-	-	-	-	-
Write-ups	-	-	-	-	-	-
<b>As at 31 Dec 2019</b>	<b>0.0</b>	<b>5.3</b>	<b>62.5</b>	<b>40.4</b>	<b>26.6</b>	<b>0.0</b>
<b>Book value as at 31 Dec 2019</b>	<b>2,397.3</b>	<b>7.4</b>	<b>1,634.2</b>	<b>12.7</b>	<b>9.9</b>	<b>0.1</b>
<b>Book value as at 31 Dec 2018</b>	<b>2,177.3</b>	<b>11.6</b>	<b>1,362.0</b>	<b>7.4</b>	<b>12.2</b>	<b>0.1</b>

<sup>1)</sup> This item includes cumulative historical depreciation recognised in the event of acquiring fixed assets in the case of transformations in accordance with section 24 of the German Transformation Act (Umwandlungsgesetz – "UmwG"), applying unchanged book values.

The assets of the split-off banking operations of the former Düsseldorf are recognised at cost within the meaning of section 253 (1) of the HGB, determined using the book values reported in the closing balance sheet of the transferring legal entity in accordance with section 24 of the UmwG. The original cost and any accumulated depreciation, amortisation and write-downs of the transferring legal entity are shown separately in the statement of fixed assets as an addition to historical cost and an addition to accumulated depreciation, amortisation and write-downs.

As at 31 December 2019, the securities held as fixed assets include bonds of North American financial institutions as well as securities issued by Eastern European and South-West European debtors. The following performance was recognised:

	Book value 31 Dec 2019	Market value 31 Dec 2019	Book value 31 Dec 2018	Market value 31 Dec 2018
€ mn				
Bank bonds	51.4	56.2	51.1	52.8
Covered bonds	-	-	-	-
Public-sector issuers	2,345.9	2,876.4	2,126.2	2,593.5
<b>Total</b>	<b>2,397.3</b>	<b>2,932.6</b>	<b>2,177.3</b>	<b>2,646.3</b>

Securities with a nominal amount of € 2,310.1 million (2018: € 2,127.7 million) were not measured at the lower of cost or market. For five securities issued by a public-sector entity, the book value in the amount of € 234.2 million (2018: € 89.4 million) is higher than the market value of € 231.7 million (2018: € 89.1 million). An examination of cost vs. market values as at 31 December 2019 did not indicate any permanent impairment.

The option to aggregate non-trading assets, pursuant to section 34 (3) of the RechKredV, has been exercised.

The Bank has rented the majority of business land and buildings used for its business operations from one of its subsidiaries.

## (28) Notes on affiliated companies and enterprises with a participatory interest

€ mn	Affiliated companies 2019		Enterprises with a participatory interest 2019		Affiliated companies 2018		Enterprises with a participatory interest 2018	
	Certi- ficated	Not certi- ficated	Certi- ficated	Not certi- ficated	Certi- ficated	Not certi- ficated	Certi- ficated	Not certi- ficated
Loans and advances to banks	-	-	-	-	-	-	-	-
Loans and advances to customers	-	2,554.7	-	16.0	-	4,171.0	-	17.9
Debt and other fixed-income securities	-	-	-	-	-	-	-	-
Liabilities to banks	-	-	-	-	-	-	-	-
Liabilities to customers	-	678.0	-	0.3	-	1,168.3	-	-
Securitised liabilities	-	-	-	-	-	-	-	-
Subordinated liabilities	-	-	-	-	-	-	-	-

Transactions with related parties are carried out on an arm's length basis. No loans were extended to members of executive bodies of Aareal Bank.

## (29) Trust business

€ mn	31 Dec 2019	31 Dec 2018
<b>Trust assets</b>		
Loans and advances to customers	21.4	34.4
Equities and other non-fixed-income securities	1.5	1.5
<b>Total trust assets</b>	<b>22.9</b>	<b>35.9</b>
<b>Trust liabilities</b>		
Liabilities to banks	1.0	1.0
Liabilities to customers	21.9	34.9
<b>Total trust liabilities</b>	<b>22.9</b>	<b>35.9</b>



### (30) Other assets

Other assets include, in particular, receivables from the asset item recognised from currency translation (€ 130.3 million), tax receivables (€ 18.3 million), and receivables from profit distributions or profit assumptions (€ 34.0 million). In addition, other assets include receivables from the collateralisation of irrevocable payment obligations to the FMSA resulting from the bank levy, and to the deposit guarantee scheme of German banks in an aggregate amount of € 25.6 million.

In the previous year, other assets included, in particular, the asset item recognised from currency translation, in the amount of € 394.9 million. Furthermore, the previous year's figure comprised tax receivables of € 26.0 million and receivables from profit distributions or profit assumptions in the amount of € 86.2 million. In addition, other assets included receivables from the collateralisation of irrevocable payment obligations to the FMSA resulting from the bank levy, and to the deposit guarantee scheme of German banks in an aggregate amount of € 17.2 million.

### (31) Prepaid expenses and deferred income

Prepaid expenses and deferred income primarily include upfront payments as well as any premiums and discounts on registered bonds, claims under promissory note loans, issued bonds and other loans as well as fee portions with interest-paying characteristics, which have been amortised over the relevant terms.

Prepaid expenses in the amount of € 211.0 million (2018: € 218.7 million) primarily include € 12.7 million (2018: € 12.1 million) in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB and € 169.3 million (2018: € 169.5 million) in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB. The item also includes € 24.4 million (2018: € 26.9 million) from upfront payments/option premiums in connection with derivatives.

€ 136.2 million (2018: € 131.6 million) of deferred income refers to upfront payments/option premiums in connection with derivatives (€ 51.7 million; 2018: € 51.9 million), while € 4.1 million (2018: € 3.9 million) refers to discounts on originated loans, in accordance with section 340e (2) sentence 2 of the HGB, and to fee portions with interest-paying characteristics in the amount of € 74.4 million (2018: € 70.3 million).

### (32) Deferred taxes

As at 31 December 2019, the Bank's deferred tax assets exceeded its deferred tax liabilities by € 302.4 million (2018: € 259.1 million). Deferred taxes are recorded in the amount of the assumed tax burden or relief in coming financial years, and are measured using the company- and country-specific tax rates expected to apply at the time of the realisation of temporary differences and the offsetting of loss carryforwards.

For Germany, we used a corporate income tax rate (including solidarity surcharge) of 15.8% and a municipal trade tax rate, depending on the multiplier set by the relevant local authorities. This results in an overall tax rate of 31.7% for Germany (2018: 31.7%).

Deferred tax assets were largely recognised for valuation differences for loans and advances to customers compared to their tax base, provisions for impending losses from executory contracts, as required under German commercial law, prepaid expenses for collected loan fees as well as on provisions for pensions. Deferred tax assets in the amount of € 2.1 million (2018: € 1.7 million) were recognised for loss carryforwards, relating exclusively to foreign permanent establishments of Aareal Bank AG.

Deferred tax liabilities were mainly attributable to the split-off portfolios of former WestImmo (€ 31.2 million; 2018: € 29.2 million), former Düsseldorf Hypothekenbank AG (€ 33.6 million) and former Corealcredit Bank AG (€ 2.0 million; 2018: € 2.5 million). As in the previous year, they were offset against deferred tax assets.

	31 Dec 2019	31 Dec 2018	Change in the year under review
€ mn			
Net deferred tax assets	302.4	259.1	43.3

### (33) Other liabilities

Other liabilities largely include trade accounts payable of € 13.3 million. In addition, other liabilities included € 237.9 million in liabilities recognised from currency translation as well as € 73.2 million in liabilities from the adjustment item due to the split-off of the banking operations of Düsseldorf. In addition, € 14.7 million in liabilities from profit and loss transfer agreements and tax liabilities of € 4.7 million have been recognised.

In the previous year, other liabilities mainly comprised € 16.1 million in trade payables, € 91.4 million in liabilities recognised from currency translation, € 3.0 million in liabilities from profit and loss transfer agreements as well as € 7.0 million in tax liabilities.

### (34) Provisions for pensions and similar obligations

The values determined in the actuarial pension report are based on the following methods and assumptions. In this context, the collection of personnel data and the determination of the forecast interest rate were made as at 1 October 2019 (cut-off date), not as at the balance sheet date:

	31 Dec 2019	31 Dec 2018
Actuarial method applied:	Projected unit credit method	Projected unit credit method
<b>Fundamental assumptions for calculation:</b>		
Discount rate in %	2.71	3.21
Reference period for discount rate	10 years	10 years
Fluctuation (%)	3.00	3.00
Expected wage and salary increases in %	2.00	2.00
Adjustments of current pension payments (%)	1.00 or 1.75	1.00 or 1.75
Mortality tables used	"Richttafeln 2018G" mortality tables by K. Heubeck	"Richttafeln 2018G" mortality tables by K. Heubeck

The effect from the changes in the discount rate as at the end of the financial year compared to the discount rate as at the beginning of the financial year is recognised in staff expenses.

The fair value changes of the plan assets are shown together with the current income from plan assets under other operating income and expenses.

Assets which are held exclusively for the purpose of fulfilling pension obligations are netted against provisions for pensions, within the framework of a Contractual Trust Agreement (CTA) where the trustee is acting on behalf of both parties (in the capacity of an administrative trustee and security trustee).

	31 Dec 2019	31 Dec 2018
€ mn		
Pension obligation	304.1	274.3
Fair value of plan assets	91.2	80.5
Cost of plan assets	85.0	75.9
<b>Provisions for pensions and similar obligations</b>	<b>212.9</b>	<b>193.8</b>

The plan assets comprise the following items, all of which are exclusively reserved to meet Aareal Bank AG's pension obligations vis-à-vis its active and retired employees in Germany.

Fund units are recognised at fair value, resulting from the exchange prices and market values of the assets, while reinsurance cover is recorded at capitalised value (Aktivwert).

€ mn	31 Dec 2019	31 Dec 2018
Fund units	61.3	52.6
Reinsurance cover	29.9	27.9
<b>Fair value of plan assets</b>	<b>91.2</b>	<b>80.5</b>

The following table shows the income and expenses in relation to pension obligations and the associated plan assets that were offset and recognised in the income statement of the reporting year.

€ mn	31 Dec 2019	31 Dec 2018
Interest cost on pension obligations	8.4	8.6
Income from plan assets	5.4	-1.2
<b>Net interest expense</b>	<b>3.0</b>	<b>9.8</b>

### (35) Subordinated liabilities

Outstanding subordinated liabilities of Tier 2 capital are not subject to any prerequisites for the conversion into equity capital or into another type of debt.

Subordinated funds raised do not provide for any early repayment obligation for Aareal Bank AG. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors of Aareal Bank AG, which are not themselves subordinated. This also applies to those subordinated funds raised that are not specified in detail.

On the reporting date, there was a subordinated liability of € 300.0 million (2018: € 300.0 million) with a fixed rate of 4.25% p.a. until 2021, maturing on 18 March 2026.

Interest expenses for all subordinated liabilities amounted to € 39.7 million (2018: € 41.4 million), including an amount of € 23.6 million (2018: € 25.1 million) for accrued interest payments not yet due.

### (36) Additional Tier 1 capital instruments

#### Additional Tier 1 bond (AT1 bond)

On 13 November 2014, the Management Board issued notes in an aggregate nominal amount of € 300 million with a denomination of € 200,000 and an initial interest rate of 7.625%, based on the authorisation granted by the Annual General Meeting on 21 May 2014.

The notes bear interest of 7.625% p.a. from the interest commencement date to 30 April 2020. The rate of interest for any interest period commencing on or after 30 April 2020 shall be equal to the reference rate (one-year EUR swap rate) determined on the relevant interest determination date plus a margin of 7.18% p.a.

The notes constitute unsecured and subordinated obligations of the issuer.

Upon the occurrence of a trigger event, the redemption amount and the principal amount of each note shall be reduced by the amount of the relevant write-down. The write-down shall be effected pro rata with all other Additional Tier 1 instruments within the meaning of the CRR, the terms of which provide for a write-down upon the occurrence of the trigger event. A trigger event occurs if the Common Equity Tier 1 capital ratio, pursuant to Article 92 (1) (a) CRR or a successor provision, and determined on a consolidated basis, falls below 7.0%. After a write-down has been effected, the principal amount and the redemption amount of each note, unless previously redeemed or repurchased and cancelled, may be written up in each of the financial years of the issuer subsequent to such write-down until the full initial principal amount has been reached.

The notes may be redeemed, in whole but not in part, at any time at the option of the issuer, subject to prior consent of the competent supervisory authority, upon not less than 30 and not more than 60 days' prior notice of redemption at their redemption amount (taking into account a potential write-

down) together with interest accrued until the redemption date (to the extent that interest payment is not cancelled or ruled out in accordance with the terms and conditions of the notes), when the tax or regulatory reasons set out in the terms and conditions of the notes apply. The issuer may also redeem the notes, in whole but not in part, at any time, subject to the prior consent of the competent supervisory authority, upon not less than 30 days' notice of redemption with effect as at 30 April 2020 for the first time and, thereafter, with effect as at each interest payment date at their redemption amount together with interest (if any) accrued to the redemption date.

Interest expenses for debt securities amounted to € 22.9 million (2018: € 22.9 million), including an amount of € 15.4 million (2018: € 15.4 million) for accrued interest payments not yet due.

### (37) Equity

Equity changed as follows:

€ mn	Subscribed capital	Capital reserves	Retained earnings		Net retained profit	Equity
			Legal reserve	Other retained earnings		
<b>As at 1 Jan 2019</b>	<b>179.6</b>	<b>727.8</b>	<b>4.5</b>	<b>720.2</b>	<b>125.7</b>	<b>1,757.8</b>
Capital increase	-	-	-	-	-	-
Dividends distributed in 2019	-	-	-	-	-125.7	-125.7
Transfer from net income 2019	-	-	-	-	119.7	119.7
<b>As at 31 Dec 2019</b>	<b>179.6</b>	<b>727.8</b>	<b>4.5</b>	<b>720.2</b>	<b>119.7</b>	<b>1,751.8</b>

The Bank utilises the rules set out in section 2a of the KWG in conjunction with Article 7 of the CRR pursuant to which regulatory indicators of own funds can only be determined at Group level. As a result, regulatory details no longer need to be disclosed at a single-entity level in this context.

#### Subscribed capital

Subscribed capital amounts to € 179.6 million (2018: € 179.6 million) and is divided into 59,857,221 (2018: 59,857,221) bearer shares with a proportionate share in the nominal share capital of € 3.00 per share.

#### Treasury shares

The General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) No. 7 of the AktG, to purchase and sell treasury shares for the purposes of securities trading, at a price not falling below or exceeding the average closing price of the Company's share in Xetra trading (or a comparable successor system) during the three trading days on the Frankfurt Stock Exchange prior to the relevant transaction by more than 10%. This authorisation expires on 19 May 2020. The volume of shares acquired for this purpose must not exceed 5% of the share capital of Aareal Bank AG at the end of any given day.

Furthermore, the Management Board was authorised by means of a resolution of the General Meeting held on 20 May 2015, pursuant to section 71 (1) no. 8 of the AktG, to purchase treasury shares in a volume of up to 10% of the share capital for purposes other than trading in treasury shares. This authorisation expires on 19 May 2020. Such purchases may be effected via stock exchanges or public purchase offers made to all shareholders, taking into account the prices as specified in the respective Annual General Meeting's resolution, which are in turn based on the Company's stock exchange share price. This authorisation may be exercised, in full or in part, on one or more occasions.

The shares acquired in accordance with this or an earlier authorisation may be sold, subject to Supervisory Board approval, outside the stock exchange and without an offer directed at all shareholders, subject to the exclusion of shareholders' pre-emptive rights, when the shares sold do not exceed 10% of the share capital and the issue price is not significantly below the prevailing stock exchange price or in the event of a sale against contributions in kind, or when the shares sold are used to service rights from convertible bonds or bonds with warrants. This also applies to shares issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without such a withdrawal or its implementation requiring a further resolution by the General Meeting.

The Management Board was also authorised to effect the acquisition of treasury shares by using put or call options. However, any and all share purchases involving the use of derivatives shall be limited to a maximum threshold value of 5% of the Company's share capital. In addition, any acquisition of shares shall count towards the 10% threshold for the authorisation for the acquisition of treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

### Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 31 May 2017. Accordingly, the Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2017) by issuance of new no-par value bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 30 May 2022. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

- a) In the event of a capital increase against cash contributions, provided that the issue price of the new shares is not significantly below the prevailing stock exchange price of the Company's listed shares at the time of the final determination of the issue price. However, this authorisation shall be subject to the proviso that the aggregate value of shares sold to the exclusion of shareholders' subscription rights, in accordance with section 203 (1) or (2) and section 186 (3) sentence 4 of the AktG, shall not exceed 10% of the issued share capital at the time said authorisation comes into effect or – if lower – at the time it is exercised. Any shares that were issued or sold during the term and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of 10% of the issued share capital. Said ten-per-cent threshold shall also include shares the issuance of which is required under the terms of debt securities with embedded conversion or option rights on shares issued pursuant to section 186 (3) sentence 4 of the AktG (excluding shareholders' subscription rights), which were (or may be) issued during the validity of this authorisation;
- b) for fractional amounts arising from the determination of the applicable subscription ratio;
- c) where this is necessary to grant subscription rights to the holders of bonds with warrants or convertible bonds issued (or to be issued) by the Company or its affiliated companies, which subscription rights are required to entitle these holders to the same extent as they would have been entitled to upon exercising their conversion or option rights or upon performance of a conversion obligation, if any, thus protecting such holders against dilution;
- d) for an amount of up to € 4,000,000 to offer employees (of the Company or its affiliated companies) shares for subscription.
- e) in the event of a capital increase against contributions in kind for the purpose of acquiring companies, divisions of companies or interests in companies or other assets.

The above authorisation for the exclusion of shareholders' subscription rights in the case of capital increases against contributions in cash or in kind is limited to a total of 20% of the share capital; this limit may be exceeded neither at the time said authorisation comes into effect, nor at the time it is exercised. The above-mentioned 20% threshold shall furthermore include treasury shares which are sold to the exclusion of shareholders' subscription rights during the validity of this authorisation as well as such shares which are issued to service debt securities, provided that the debt securities were issued to the exclusion of shareholders' subscription rights during the validity of this authorisation due to the authorisation under agenda item 6 of the Annual General Meeting on 21 May 2014. When a new authorisation for the exclusion of shareholders' subscription rights is resolved after the reduction and said new authorisation comes into effect, the upper limit, reduced in accordance with the above-mentioned requirements, shall be increased again to the amount permitted by the new authorisation, with a maximum total of 20% of the share capital in accordance with the above-mentioned requirements.

The authorised capital has not yet been utilised.

### Conditional capital

Based on a resolution passed by the General Meeting on 22 May 2019, the Management Board was authorised to issue, on one or more occasions until 21 May 2024, profit-participation certificates

with a limited or unlimited term for contribution in cash or in kind of up to € 900,000,000. The profit-participation certificates must be constructed in such a way that the funds paid for them after issuance can be recognised as banking regulatory capital pursuant to the legal regulations applicable as at the time of issuance. Profit-participation certificates and other hybrid promissory note loans to be issued according to this authorisation shall be connected with conversion rights for the holder, entitling or compelling, in accordance with their respective conditions, the holder to purchase Company shares. Conversion rights or obligations may be attached exclusively to bearer no-par value shares and are limited to a maximum amount of € 71,828,664.00 of the Company's share capital. The sum of shares to be issued so as to service conversion or option rights or conversion obligations from profit-participation certificates or hybrid promissory note loans issued pursuant to this authorisation, including shares issued during validity of this authorisation as a result of another authorisation (especially from the Authorised Capital 2017), may not exceed an amount of € 71,828,664.00 (which equals approx. 40% of the current share capital). Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

Accordingly, the Company's share capital is subject to a conditional capital increase not exceeding € 71,828,664.00 by issuance of up to 23,942,888 new no-par value bearer shares ("Conditional Capital 2019"). The purpose of the conditional capital increase is to grant shares to holders or creditors of convertible bonds issued in accordance with the aforementioned authorisation. The new no-par value bearer shares may only be issued at a conversion price in line with the resolution passed by the General Meeting on 22 May 2019. The conditional capital increase shall only be carried out insofar as conversion rights are exercised or as conversion obligations from such convertible bonds are fulfilled or as the Company makes use of alternative performance and insofar as no cash compensation is granted or treasury shares are used to service the rights. The new shares shall be entitled to a share in the profits from the beginning of the financial year in which they come into existence through the exercise of conversion rights or the fulfilment of conversion obligations. The Management Board is authorised to determine the details of the conditional capital increase. The Management Board is also authorised to determine the further contents of share rights and the terms governing the issuance of shares, subject to the approval of the Supervisory Board.

To date, the Conditional Capital has not yet been utilised.

### **(38) Contingent liabilities and other commitments**

The Bank has off-balance contingent liabilities and irrevocable loan commitments. During the term of these obligations, the Bank regularly reviews whether any losses can be expected from the utilisation of such contingent liabilities. This assessment is primarily made due to the credit risk analysis. Any losses that can be expected according to this analysis are recognised in the balance sheet as provisions, and are no longer disclosed as contingent liabilities or other liabilities.

Contingent liabilities result from guarantees and indemnity agreements, of which € 20.5 million (2018: € 11.8 million) are granted to domestic borrowers and € 26.6 million (2018: € 34.0 million) to foreign borrowers.

Liabilities did not have to be recognised for obligations from indemnity agreements vis-à-vis third parties and other obligations, which were entered into in favour of affiliated companies, as the underlying liabilities are likely to be fulfilled by the affiliated companies. Therefore, we do not expect any utilisation in this regard.

Irrevocable loan commitments are made up of credit and loan commitments, of which € 164.1 million (2018: € 47.5 million) are granted to domestic borrowers and € 2,072.3 million (2018: € 1,687.0 million) to foreign borrowers.

### **(39) Unrecognised transactions and other obligations**

Aareal Bank AG is the lessee mainly of operating leases. Rental and lease contracts relate to the buildings of the Bank's head office in Wiesbaden used for the Bank's operations, and of the foreign branch offices and representative offices as well as to the vehicle fleet and certain operating and office equipment. In all cases, the contracts are so-called operating leases which are not recognised in the financial statements of the Bank. The key benefit of such contracts is a lower amount of capital lock-up compared to an acquisition, and the elimination of realisation risk. At the moment, there are no indications that risks may result from the lease term.

Disclosures on repurchase agreements and derivatives are presented below in the Notes.

The financial amounts subject to legal disputes are within the low three-digit million range. Based on a legal analysis, successful outcome of these disputes is more likely than not, and therefore, no liabilities are recognised in the financial statements.

There are fully cash-collateralised and irrevocable payment obligations from the bank levy and the deposit guarantee scheme of German banks. Cash collateral is reported under other assets.

#### (40) Maturity groupings

€ mn	31 Dec 2019	31 Dec 2018
<b>Loans and advances to banks</b>	<b>1,425.9</b>	<b>821.0</b>
With a residual term of		
Payable on demand	1,121.1	545.6
Up to 3 months	-	-
Between 3 months and 1 year	69.8	38.9
Between 1 year and 5 years	-	0.7
More than five years	25.1	13.1
Pro rata interest	209.9	222.7
<b>Loans and advances to customers</b>	<b>26,519.2</b>	<b>27,223.1</b>
With a residual term of		
Payable on demand	563.7	308.6
Up to 3 months	295.3	910.3
Between 3 months and 1 year	3,043.2	2,474.0
Between 1 year and 5 years	15,774.3	15,289.4
More than five years	6,738.6	8,143.2
Pro rata interest	104.1	97.6
<b>Debt and other fixed-income securities maturing in the following year (nominal amount)</b>	<b>867.5</b>	<b>1,842.9</b>
<b>Liabilities to banks</b>	<b>1,683.7</b>	<b>1,917.1</b>
With a residual term of		
Payable on demand	709.7	721.8
Up to 3 months	59.1	40.7
Between 3 months and 1 year	76.1	281.1
Between 1 year and 5 years	335.7	351.0
More than five years	334.4	343.2
Pro rata interest	168.7	179.3
<b>Liabilities to customers</b>	<b>-</b>	<b>-</b>
<b>Other liabilities to customers</b>	<b>22,746.6</b>	<b>23,892.1</b>
With a residual term of		
Payable on demand	8,516.2	8,986.5
Up to 3 months	3,316.2	3,305.9
Between 3 months and 1 year	2,435.6	2,639.1
Between 1 year and 5 years	3,236.6	3,463.3
More than five years	5,065.4	5,312.9
Pro rata interest	176.6	184.4
<b>Bonds issued maturing in the following year (nominal amount)</b>	<b>1,445.0</b>	<b>2,121.2</b>
<b>Other certificated liabilities</b>	<b>-</b>	<b>-</b>

## (41) Shareholdings

The following disclosures are made pursuant to section 285 (11) of the HGB:

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
1	Aareal Bank Asia Limited	Singapore	100.0	SGD 22.7 mn	SGD 4.2 mn <sup>1)</sup>
2	Aareal Beteiligungen AG	Frankfurt	100.0	167.0	0.0 <sup>3)</sup>
3	Aareal Capital Corporation	Wilmington	100.0	USD 1,018.8 mn	USD 11.7 mn <sup>4)</sup>
4	Aareal Estate AG	Wiesbaden	100.0	2.9	0.0 <sup>3)</sup>
5	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 <sup>3)</sup>
6	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.7	0.1 <sup>1)</sup>
7	Aareal Holding Realty LP	Wilmington	99.8	USD 221.4 mn	USD -0.3 mn <sup>4)</sup>
8	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	419.7	0.0 <sup>3)</sup>
9	Aareon AG	Mainz	100.0	165.7	26.3
10	Aareon Deutschland GmbH	Mainz	100.0	34.7	0.0 <sup>3)</sup>
11	Aareon Finland Oy	Helsinki	100.0	0.0	-0.3 <sup>1)</sup>
12	Aareon France S.A.S.	Meudon-la-Forêt	100.0	9.5	3.6 <sup>2)</sup>
13	Aareon Nederland B.V.	Emmen	100.0	28.2	2.0 <sup>2)</sup>
14	Aareon Norge AS	Oslo	100.0	NOK 5.7 mn	NOK -19.9 mn <sup>2)</sup>
15	Aareon Planungs- und Bestandsentwicklungs GmbH	Mainz	100.0	-0.4	-0.5 <sup>1)</sup>
16	Aareon RELion GmbH	Augsburg	100.0	-0.4	-0.5 <sup>2)</sup>
17	Aareon RELion Nord GmbH	Hamburg	100.0	1.1	0.4 <sup>2)</sup>
18	Aareon RELion Süd GmbH	Augsburg	100.0	0.6	0.4 <sup>2)</sup>
19	Aareon Sverige AB	Mölnådal	100.0	SEK 26.1 mn	SEK -24.9 mn <sup>2)</sup>
20	Aareon UK Ltd.	Coventry	100.0	GBP 4.8 mn	GBP 0.4 mn <sup>2)</sup>
21	AV Management GmbH	Mainz	100.0	0.4	0.0 <sup>3)</sup>
22	BauContact Immobilien GmbH	Wiesbaden	100.0	8.5	0.7
23	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 <sup>3)</sup>
24	BauGrund Solida Immobilien GmbH	Frankfurt	100.0	0.1	0.0 <sup>1)</sup>
25	BauGrund TVG GmbH	Munich	100.0	0.1	0.0 <sup>1)</sup>
26	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.6	3.5 <sup>2)</sup>
27	blackprint Booster Fonds International GmbH & Co. KG	Frankfurt	49.9	0.8	0.0 <sup>1)</sup>
28	BVG - Grundstücks- und Verwertungsgesellschaft mit beschränkter Haftung	Frankfurt	100.0	152.3	0.0 <sup>3)</sup>
29	Cave Nuove S.p.A.	Rome	100.0	-76.9	0.0
30	CredaRate Solutions GmbH	Cologne	12.9	3.0	1.0 <sup>2)</sup>
31	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	0.5	0.0 <sup>1)</sup>
32	Deutsche Structured Finance GmbH	Wiesbaden	100.0	3.0	-1.3
33	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 <sup>3)</sup>

<sup>1)</sup> Preliminary figures as at 31 December 2019; <sup>2)</sup> Equity and results as at 31 December 2018;

<sup>3)</sup> Profit transfer agreement / control and profit transfer agreement; <sup>4)</sup> Disclosures in accordance with IFRSs



No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
34	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Bremen	48.4	0.3	0.0 <sup>2)</sup>
35	DHB Verwaltungs AG	Wiesbaden	100.0	5.1	0.0 <sup>3)</sup>
36	FIRE B.V.	Utrecht	60.0	0.0	0.0 <sup>2)</sup>
37	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	3.0	0.0 <sup>3)</sup>
38	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0
39	GVN-Grundstücks- und Vermögensverwaltungs- gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 <sup>3)</sup>
40	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.5	0.0 <sup>1)</sup>
41	Izalco Spain S.L.	Madrid	100.0	13.3	-0.5 <sup>1)</sup>
42	Jomo S.p.r.l.	Brussels	100.0	26.4	1.0 <sup>1)</sup>
43	Kalshoven Automation B.V.	Amsterdam	100.0	1.2	0.7 <sup>2)</sup>
44	Konsortium BauGrund/TREUREAL	Bonn	50.0	0.0	0.0 <sup>1)</sup>
45	La Sessola Holding GmbH	Wiesbaden	100.0	86.6	0.0 <sup>1)</sup>
46	La Sessola S.r.l.	Rome	100.0	107.7	-7.3 <sup>1)</sup>
47	La Sessola Service S.r.l.	Rome	100.0	4.5	-0.2 <sup>1)</sup>
48	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn <sup>4)</sup>
49	Mercadea S.r.l.	Rome	100.0	7.3	0.0 <sup>1)</sup>
50	Mirante S.r.l.	Rome	100.0	4.6	-0.6 <sup>1)</sup>
51	Mount Street Group Limited	London	20.0	GBP 3.1 mn	GBP 4.4 mn <sup>1)</sup>
52	Northpark Realty LP	Wilmington	100.0	USD 118.0 mn	USD 3.0 mn <sup>4)</sup>
53	OFI Group GmbH	Frankfurt	35.8	0.4	-0.6 <sup>1)</sup>
54	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	3.0	0.0 <sup>3)</sup>
55	Participation Elfte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 <sup>3)</sup>
56	Participation Zehnte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 <sup>3)</sup>
57	phi-Consulting GmbH	Bochum	100.0	1.9	0.2 <sup>2)</sup>
58	Pisana S.p.A.	Rome	100.0	-17.1	0.0
59	plusForta GmbH	Dusseldorf	100.0	0.2	0.0 <sup>3)</sup>
60	PropTech1 Fund I GmbH & Co. KG	Berlin	22.7	21.2	0.0 <sup>1)</sup>
61	Sedum Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG	Wiesbaden	94.9	-2.0	3.4 <sup>1)</sup>
62	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	100.0	23.8	0.0 <sup>3)</sup>
63	Terrain Beteiligungen GmbH	Wiesbaden	94.0	57.6	1.0 <sup>1)</sup>
64	Westdeutsche Immobilien Servicing AG	Mainz	100.0	50.1	0.0 <sup>3)</sup>
65	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	0.0	0.0 <sup>2)</sup>
66	WP Galleria Realty LP	Wilmington	100.0	USD 124.1 mn	USD 0.8 mn <sup>4)</sup>

<sup>1)</sup> Preliminary figures as at 31 December 2019; <sup>2)</sup> Equity and results as at 31 December 2018;

<sup>3)</sup> Profit transfer agreement / control and profit transfer agreement; <sup>4)</sup> Disclosures in accordance with IFRSs

## (42) Assets pledged as collateral

Assets in the amount stated were pledged for the following liabilities:

€ mn	31 Dec 2019	31 Dec 2018
Liabilities to banks	1,315.7	712.4
Liabilities to customers	72.8	-
<b>Total</b>	<b>1,388.5</b>	<b>712.4</b>

Other assets include the cash-collateralised and irrevocable payment obligation to the FMSA resulting from the bank levy and the deposit protection fund, for which € 25.7 million (2018: € 14.5 million) in cash collateral has been pledged.

## (43) Repurchase agreements

As at 31 December 2019, no bonds were used as part of repurchase agreements (2018: € –).

## (44) Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies was € 14,272.5 million (2018: € 14,386.1 million) at the balance sheet date, whilst liabilities totalled € 2,536.4 million (2018: € 3,167.0 million). Foreign currency balances are partly offset by equivalent foreign exchange forwards and currency swaps.

## (45) Forward transactions

The following forward transactions had been entered into as at 31 December 2019:

- ◆ Transactions based on interest rates: caps, floors, swaptions, interest rate swaps
- ◆ Transactions based on exchange rates: forward foreign exchange transactions, cross-currency swaps
- ◆ Other transactions: other forward transactions

Interest-rate based transactions and cross-currency swaps are primarily used to hedge against interest rate and exchange rate fluctuations. Forward foreign exchange transactions are almost exclusively used for the purposes of funding hedges.

Remaining terms and future cash flows of derivatives are broken down in the following table:

### 31 December 2019

	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
€ mn					
<b>Interest rate instruments</b>					
Interest rate swaps					
Cash inflows	137.5	388.7	1,046.8	266.9	1,840.0
Cash outflows	136.3	269.8	875.0	280.2	1,561.3
Caps, floors					
Cash inflows	0.0	0.0	0.8	0.1	0.9
Cash outflows	0.0	0.0	0.8	0.1	0.9
<b>Currency-related instruments</b>					
Spot and forward foreign exchange transactions					
Cash inflows	2,209.8	273.8	-	-	2,483.6
Cash outflows	2,225.5	273.7	-	-	2,499.2
Cross-currency swaps					
Cash inflows	897.4	1,048.2	8,483.7	0.0	10,429.3
Cash outflows	949.3	1,210.9	9,041.2	53.2	11,254.5
<b>Total cash inflows</b>	<b>3,244.7</b>	<b>1,710.7</b>	<b>9,531.3</b>	<b>267.0</b>	<b>14,753.8</b>
<b>Total cash outflows</b>	<b>3,311.1</b>	<b>1,754.4</b>	<b>9,917.0</b>	<b>333.5</b>	<b>15,315.9</b>

### 31 Dec 2018

	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
€ mn					
<b>Interest rate instruments</b>					
Interest rate swaps					
Cash inflows	143.6	396.5	1,246.1	357.0	2,143.2
Cash outflows	145.8	271.9	953.2	344.2	1,715.1
Caps, floors					
Cash inflows	0.4	1.6	3.7	0.5	6.2
Cash outflows	0.4	1.6	3.7	0.5	6.2
<b>Currency-related instruments</b>					
Spot and forward foreign exchange transactions					
Cash inflows	1,574.7	238.0	-	-	1,812.7
Cash outflows	1,565.6	237.9	-	-	1,803.5
Cross-currency swaps					
Cash inflows	508.3	1,504.4	6,852.0	52.6	8,917.3
Cash outflows	548.7	1,613.2	7,193.1	0.0	9,355.0
<b>Total cash inflows</b>	<b>2,227.0</b>	<b>2,140.5</b>	<b>8,101.8</b>	<b>410.1</b>	<b>12,879.4</b>
<b>Total cash outflows</b>	<b>2,260.5</b>	<b>2,124.6</b>	<b>8,150.0</b>	<b>344.7</b>	<b>12,879.8</b>

The following overview shows positive and negative market values, aggregated by product level (without taking collateral or netting agreements into account):

Unless a quoted market price is available, derivatives are measured using generally accepted methods on the basis of current market parameters (yield curves, volatility factors etc.). Methods used include standard methods and models such as discounted cash flow analyses and option pricing models. Structured products are measured after they have been split into their individual components. Fair values including accrued interest are given for derivative financial instruments not recognised at fair value as at 31 December 2019.

€ mn	Nominal amount 31 Dec 2019	Market value as at 31 Dec 2019		Market value as at 31 Dec 2018	
		Positive	Negative	Positive	Negative
<b>Interest rate instruments</b>					
OTC products					
Interest rate swaps	40,377.0	1,567.6	1,722.0	1,370.7	1,354.0
Swaptions	6,704.7	-	-	-	-
Caps, floors	10.0	0.9	0.9	6.1	6.1
<b>Total interest rate instruments</b>	<b>47,091.7</b>	<b>1,568.5</b>	<b>1,722.9</b>	<b>1,376.8</b>	<b>1,360.1</b>
<b>Currency-related instruments</b>					
OTC products					
Spot and forward foreign exchange transactions	2,441.9	4.2	20.8	13.9	2.9
Cross-currency swaps	12,394.6	234.0	423.6	452.5	248.0
<b>Total currency-related instruments</b>	<b>14,836.5</b>	<b>238.2</b>	<b>444.4</b>	<b>466.4</b>	<b>250.9</b>
<b>Total</b>	<b>61,928.2</b>	<b>1,806.7</b>	<b>2,167.3</b>	<b>1,843.2</b>	<b>1,611.0</b>

The year-on-year net decrease in market values is attributable to exchange rate developments, in addition to the changes in interest rates. Currency hedges are largely used to hedge foreign exchange risk in the lending business.

Derivatives have been entered into with the following counterparties:

€ mn	Market value as at 31 Dec 2019		Market value as at 31 Dec 2018	
	Positive	Negative	Positive	Negative
OECD public-sector authorities	4.0	46.9	-	-
OECD banks	1,696.4	2,086.6	1,735.1	1,602.0
Non-OECD banks	-	-	-	9.0
Companies and private individuals	106.3	33.8	108.1	-
<b>Total</b>	<b>1,806.7</b>	<b>2,167.3</b>	<b>1,843.2</b>	<b>1,611.0</b>

## Other Disclosures

### (46) Declaration pursuant to section 28 of the German Pfandbrief Act (Pfandbriefgesetz – "PfandBG")

#### Public-sector lending

Total volume of outstanding public-sector Pfandbriefe and of the related cover assets in terms of nominal value and present value (section 28 (1) nos. 1 and 3 of the PfandBG):

€ mn	31 Dec 2019			31 Dec 2018		
	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>	Excess cover	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>	Excess cover
<b>Nominal value</b>	2,242.9	2,073.6	169.3	1,886.9	1,619.2	267.7
thereof: derivatives	-	-	-	-	-	-
<b>Present value</b>	3,096.2	2,620.9	475.3	2,518.0	2,107.7	410.3
thereof: derivatives	82.2	-	-	114.8	-	-
<b>Risk-adjusted net present value<sup>2)</sup></b>	2,848.6	2,506.2	342.4	2,331.3	1,987.9	343.4

<sup>1)</sup> Of which transferred to own holdings: € 0 million (2018: € 0 million)

<sup>2)</sup> Dynamic method pursuant to section 5 PfandBarwertV/static method pursuant to section 6 PfandBarwertV

Maturity structure of outstanding public-sector Pfandbriefe and fixed-interest periods of the related cover assets (section 28 (1) no. 2 of the PfandBG):

€ mn	31 Dec 2019		31 Dec 2018	
	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>
Up to 6 months	162.7	314.7	85.1	81.5
Between 6 months and 12 months	79.6	226.1	98.5	59.7
Between 12 months and 18 months	48.1	45.3	75.6	117.6
Between 18 months and 2 years	101.5	94.0	29.3	51.1
Between 2 years and 3 years	184.9	141.5	209.3	138.3
Between 3 years and 4 years	243.8	183.4	179.7	131.5
Between 4 years and 5 years	129.6	95.1	173.3	183.4
Between 5 years and 10 years	339.8	670.4	343.4	546.2
More than 10 years	952.9	303.1	692.7	309.9
<b>Total</b>	<b>2,242.9</b>	<b>2,073.6</b>	<b>1,886.9</b>	<b>1,619.2</b>

<sup>1)</sup> Of which transferred to own holdings: € 0 million (2018: € 0 million)

Breakdown of assets used as cover for public-sector Pfandbriefe (based on their nominal value) by their amount (section 28 (3) sentence 1 of the PfandBG):

Amount classes	2019	2018
Up to € 10 million	193.7	204.7
More than € 10 million and up to € 100 million	647.4	787.5
More than € 100 million	1,371.8	894.7
<b>Total</b>	<b>2,212.9</b>	<b>1,886.9</b>

Breakdown of assets used as cover assets for public-sector Pfandbriefe (based on their nominal value), by borrower's/guarantor's country of domicile, in line with section 28 (3) no. 2 of the PfandBG:

### 31 December 2019

€ mn	Total	Total due to Guarantees promotion of export activities	of which owed by				of which guaranteed by			
			Sover-eigns	Regional	Municipal	Other	Sover-eigns	Regional	Municipal	Other
Germany	1,467.5	-	-	1,110.4	303.4	22.9	0.1	1.7	28.9	0.1
EU institutions	5.0	-	-	-	-	-	5.0	-	-	-
France	25.4	-	-	-	0.4	-	25.0	-	-	-
Italy	25.0	-	25.0	-	-	-	-	-	-	-
Japan	20.0	-	-	-	20.0	-	-	-	-	-
Austria	295.0	-	200.0	25.0	-	-	70.0	-	-	-
Portugal	35.0	-	35.0	-	-	-	-	-	-	-
Slovenia	25.0	-	25.0	-	-	-	-	-	-	-
Spain	315.0	-	155.0	130.0	5.0	25.0	-	-	-	-
<b>Total</b>	<b>2,212.9</b>	<b>-</b>	<b>440.0</b>	<b>1,265.4</b>	<b>328.8</b>	<b>47.9</b>	<b>100.1</b>	<b>1.7</b>	<b>28.9</b>	<b>0.1</b>

**31 December 2018**

	Total	Total due to Guarantees promotion of export activities	of which owed by Public-sector entities				of which guaranteed by Public-sector entities			
			Sovereigns	Regional	Municipal	Other	Sovereigns	Regional	Municipal	Other
€ mn										
Germany	1,419.7	-	-	940.2	335.5	58.0	0.2	2.1	83.7	-
EU institutions	81.4	-	-	-	-	-	81.4	-	-	-
France	25.8	-	25.0	-	0.8	-	-	-	-	-
Italy	25.0	-	25.0	-	-	-	-	-	-	-
Japan	20.0	-	-	-	20.0	-	-	-	-	-
Austria	175.0	-	100.0	25.0	-	-	50.0	-	-	-
Poland	25.0	-	25.0	-	-	-	-	-	-	-
Spain	115.0	-	-	115.0	-	-	-	-	-	-
<b>Total</b>	<b>1,886.9</b>	<b>-</b>	<b>175.0</b>	<b>1,080.2</b>	<b>356.3</b>	<b>58.0</b>	<b>131.6</b>	<b>2.1</b>	<b>83.7</b>	<b>-</b>

Additional cover assets (section 28 (1) nos. 4 and 5 of the PfandBG)

**31 December 2019**

	Equalisation claims pursuant to section 20 (2) no. 1 of the PfandBG	Money claims pursuant to section 20 (2) no. 2 of the PfandBG	
		Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013
€ mn			
<b>Countries</b>			
Germany	-	15.0	-
Austria	-	15.0	-
<b>Total</b>	<b>-</b>	<b>30.0</b>	<b>-</b>

**31 December 2018**

	Equalisation claims pursuant to section 20 (2) no. 1 of the PfandBG	Money claims pursuant to section 20 (2) no. 2 of the PfandBG	
		Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013
€ mn			
<b>Countries</b>			
Germany	-	-	-
Austria	-	-	-
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>

Additional key figures for outstanding Pfandbriefe and related cover assets:

	2019	2018
<b>Outstanding Pfandbriefe<sup>1)</sup></b>	<b>€ 2,073.6 mn</b>	<b>€ 1,619.2 mn</b>
of which: share of fixed-income Pfandbriefe	81.9%	76.9%
<b>Cover assets pool</b>	<b>€ 2,242.9 mn</b>	<b>€ 1,886.9 mn</b>
of which: total volume of receivables above the percentage limits set out in section 20 (2) of the PfandBG	-	-
of which: share of fixed-income cover assets	90.2%	88.3%

<sup>1)</sup> Of which transferred to own holdings: € 0 million (2018: € 0 million)

Net present value pursuant to section 6 of the German Regulation of the Net Present Value of Pfandbriefe (Pfandbrief-Barwertverordnung) per foreign currency:

	Balance of assets and liabilities 2019	Balance of assets and liabilities 2018
€ mn		
<b>Currency</b>		
EUR	341.3	294.3
CHF	1.3	54.6

There were no such payment arrears of 90 days or more in the reporting period, nor in the comparable period of the previous year.

No registered Public-sector Pfandbriefe were surrendered to lenders as collateral for borrowings.

### Mortgage lending

Total volume of outstanding public-sector Pfandbriefe and of the related cover assets in terms of nominal value and present value (section 28 (1) nos. 1 and 3 of the PfandBG):

	31 Dec 2019			31 Dec 2018		
	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>	Excess cover	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>	Excess cover
€ mn						
<b>Nominal value</b>	11,860.7	10,432.8	1,427.9	12,178.6	10,573.5	1,605.1
of which: derivatives	42.6	-	-	170.8	-	-
<b>Present value</b>	12,741.0	11,097.4	1,643.6	12,997.7	11,208.6	1,789.1
of which: derivatives	112.4	-	-	236.0	-	-
<b>Risk-adjusted net present value<sup>2)</sup></b>	12,906.7	11,621.0	1,285.7	13,124.1	11,594.1	1,530.0

<sup>1)</sup> Of which transferred to own holdings: €160.0 million (2018: €300.0 million)

<sup>2)</sup> Dynamic method pursuant to section 5 PfandBarwertV/static method pursuant to section 6 PfandBarwertV

Maturity structure of outstanding mortgage Pfandbriefe and fixed-interest periods of the related cover assets (section 28 (1) no. 2 of the PfandBG):

€ mn	31 Dec 2019		31 Dec 2018	
	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>	Cover assets pool	Pfandbriefe outstanding <sup>1)</sup>
Up to 6 months	821.0	712.7	1,688.1	1,603.0
Between 6 months and 12 months	793.2	751.2	953.6	712.7
Between 12 months and 18 months	749.5	218.1	525.1	747.9
Between 18 months and 2 years	1,083.0	1,071.6	903.3	750.7
Between 2 years and 3 years	1,864.8	1,883.6	1,833.1	835.7
Between 3 years and 4 years	2,561.7	1,819.1	1,797.5	1,866.3
Between 4 years and 5 years	1,736.0	1,454.3	1,403.1	1,534.2
Between 5 years and 10 years	2,224.8	2,246.0	3,040.8	2,179.0
More than 10 years	26.7	276.2	34.0	344.0
<b>Total</b>	<b>11,860.7</b>	<b>10,432.8</b>	<b>12,178.6</b>	<b>10,573.5</b>

<sup>1)</sup> Of which transferred to own holdings: € 160.0 million (2018: € 300.0 million)

Breakdown of assets used as cover (based on their nominal value) by tranches (section 28 (2) sentence 1 no. 1a of the PfandBG)

€ mn	Cover assets pool 2019	Cover assets pool 2018
<b>Breakdown of assets used as cover (based on their nominal value) by tranches</b>		
Up to € 300 thousand	309.0	408.0
Between € 300 thousand and € 1 million	62.0	80.7
Between € 1 million and € 10 million	436.3	558.7
More than € 10 million	10,125.5	9,875.4
<b>Total</b>	<b>10,932.8</b>	<b>10,922.8</b>

Additional cover assets pursuant to section 28 (1) nos. 4, 5 and 6 of the PfandBG:

### 31 December 2019

€ mn	Equalisation claims pursuant to section 20 (2) no. 1 of the PfandBG	Money claims pursuant to section 19 (2) no. 2 of the PfandBG		Debt securities pursuant to section 19 (1) no. 3 of the PfandBG	Total
		Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013		
<b>Countries</b>					
Germany	-	-	-	458.0	<b>458.0</b>
EU institutions	-	-	-	255.0	<b>255.0</b>
France	-	-	-	135.0	<b>135.0</b>
Austria	-	-	-	37.2	<b>37.2</b>
<b>Total</b>	-	-	-	<b>885.2</b>	<b>885.2</b>



**31 December 2018**

€ mn	Equalisation claims pursuant to section 20 (2) no. 1 of the PfandBG	Money claims pursuant to section 19 (2) no. 2 of the PfandBG			Total
		Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013	Debt securities pursuant to section 19 (1) no. 3 of the PfandBG	
<b>Countries</b>					
Germany	-	-	-	900.0	<b>900.0</b>
EU institutions	-	-	-	50.0	<b>50.0</b>
France	-	-	-	135.0	<b>135.0</b>
<b>Total</b>	-	-	-	<b>1,085.0</b>	<b>1,085.0</b>

Additional key figures for outstanding Pfandbriefe and related cover assets:

	2019	2018
<b>Outstanding Pfandbriefe<sup>1)</sup></b>	<b>€ 10,432.8 mn</b>	<b>€ 10,573.5 mn</b>
of which: share of fixed-income Pfandbriefe	73.8%	66.0%
<b>Cover assets pool</b>	<b>€ 11,860.7 mn</b>	<b>€ 12,178.6 mn</b>
of which: total volume of receivables above the limits set out in section 13 (1) of the PfandBG	-	-
of which: total volume of receivables above the percentages set out in section 19 (1) no. 2 of the PfandBG	-	-
of which: total volume of receivables above the percentages set out in section 19 (1) no. 3 of the PfandBG	-	-
of which: share of fixed-income cover assets	55.6%	53.4%
<b>Volume-weighted average age of receivables (seasoning)</b>	<b>4.8 years</b>	<b>5.3 years</b>
<b>Weighted average mortgage lending value ratio, based on mortgage lending value</b>	<b>55.5%</b>	<b>56.1%</b>
<b>Weighted average mortgage lending value ratio, based on market value</b>	<b>33.7%</b>	<b>35.4%</b>

<sup>1)</sup> Of which transferred to own holdings: € 160.0 million (2018: € 300.0 million)

Net present value pursuant to section 6 of the German Regulation of the Net Present Value of Pfandbriefe (Pfandbrief-Barwertverordnung) per foreign currency:

€ mn	Balance of assets and liabilities 2019	Balance of assets and liabilities 2018
<b>Currency</b>		
AUD	27.3	-
CAD	-0.3	39.5
CHF	15.8	15.5
DKK	-32.9	72.6
EUR	871.4	1,177.2
GBP	211.4	192.4
SEK	55.0	22.1
USD	229.5	71.1

Distribution of the amounts measured at nominal value and used to cover mortgage Pfandbriefe by countries in which the real property collateral is located (section 28 (2) sentence 1 no. 1b, c of the PfandBG):

**31 December 2019**

	Commercial property						Residential property					Total cover assets pool		
	Build- ing plots only	New buildings not yet yielding returns	Office build- ings	Retail	Indus- trial	Other	Total	Build- ing plots only	New build- ings not yet yielding returns	Con- do- min- iums	One- and two- family homes		Multi- family homes	Total
€ mn														
Australia	-	-	-	-	-	-	-	-	-	-	-	25.9	25.9	25.9
Belgium	-	-	58.9	81.1	1.9	62.2	204.1	-	-	-	-	-	-	204.1
Denmark	-	-	8.2	-	21.8	0.7	30.7	-	-	-	-	-	-	30.7
Germany	-	-	328.3	364.0	173.5	252.3	1,118.1	-	-	0.1	221.2	473.4	694.7	1,812.8
Estonia	-	-	-	18.7	-	-	18.7	-	-	-	-	-	-	18.7
Finland	-	-	58.4	204.0	54.5	-	316.9	-	-	-	-	-	-	316.9
France	-	92.2	1,046.9	116.1	-	69.5	1,324.7	-	-	-	-	-	-	1,324.7
UK	-	-	159.2	643.7	113.3	589.6	1,505.8	-	-	-	-	169.0	169.0	1,674.8
Italy	-	-	65.2	322.9	69.5	85.5	543.1	-	-	-	-	-	-	543.1
Canada	-	-	-	-	-	230.9	230.9	-	-	-	-	-	-	230.9
Luxembourg	-	-	-	-	-	4.5	4.5	-	-	-	-	-	-	4.5
Netherlands	-	-	49.6	15.6	54.3	461.9	581.4	-	-	-	-	-	-	581.4
Austria	-	-	-	122.0	7.0	6.9	135.9	-	-	-	-	-	-	135.9
Poland	-	-	73.8	131.0	15.4	-	220.2	-	-	-	-	-	-	220.2
Sweden	-	-	37.4	135.0	147.2	-	319.6	-	-	-	-	-	-	319.6
Switzerland	-	-	-	-	-	203.2	203.2	-	-	-	-	-	-	203.2
Spain	-	7.1	89.1	579.1	19.3	38.2	732.8	-	-	-	-	-	-	732.8
US	-	-	1,477.6	568.2	-	469.2	2,515.0	-	-	-	-	37.6	37.6	2,552.6
<b>Total</b>	-	<b>99.3</b>	<b>3,452.6</b>	<b>3,301.4</b>	<b>677.7</b>	<b>2,474.6</b>	<b>10,005.6</b>	-	-	<b>0.1</b>	<b>221.2</b>	<b>705.9</b>	<b>927.2</b>	<b>10,932.8</b>

**31 December 2018**

€ mn	Commercial property						Residential property					Total cover assets pool		
	Build- ing plots only	New build- ings not yet returns	Office build- ings	Retail prop- erty	Indus- trial	Other	Total	Build- ing plots only	New build- ings not yet returns	Con- do- min- iums	One- and two- family homes		Multi- family homes	Total
Belgium	-	-	99.1	101.5	1.9	18.1	220.6	-	-	-	-	-	-	220.6
Denmark	-	57.3	15.5	-	21.8	33.5	128.1	-	-	-	-	7.6	7.6	135.7
Germany	-	17.5	359.3	297.8	184.8	365.1	1,224.5	-	-	0.1	297.1	554.0	851.2	2,075.7
Estonia	-	-	-	18.7	-	-	18.7	-	-	-	-	-	-	18.7
Finland	-	-	58.4	100.1	11.8	-	170.3	-	-	-	-	-	-	170.3
France	-	55.0	677.1	165.3	69.3	140.9	1,107.6	-	-	-	-	-	-	1,107.6
UK	-	-	179.9	843.5	84.2	634.8	1,742.4	-	-	-	-	109.2	109.2	1,851.6
Italy	-	-	114.0	413.7	87.3	72.8	687.8	-	-	-	-	84.2	84.2	772.0
Canada	-	-	-	-	-	231.9	231.9	-	-	-	-	-	-	231.9
Luxembourg	-	-	-	-	-	4.5	4.5	-	-	-	-	-	-	4.5
Netherlands	-	-	50.3	10.6	35.4	462.2	558.5	-	-	-	-	-	-	558.5
Austria	-	-	-	122.0	-	6.9	128.9	-	-	-	-	-	-	128.9
Poland	-	-	141.7	163.6	-	-	305.3	-	-	-	-	-	-	305.3
Sweden	-	-	-	127.3	163.6	-	290.9	-	-	-	-	-	-	290.9
Switzerland	-	-	-	-	-	195.7	195.7	-	-	-	-	-	-	195.7
Spain	-	-	92.7	391.0	19.3	55.0	558.0	-	-	-	-	-	-	558.0
US	-	-	1,237.3	587.1	-	419.3	2,243.7	-	-	-	-	53.2	53.2	2,296.9
<b>Total</b>	-	129.8	3,025.3	3,342.2	679.4	2,640.7	9,817.4	-	-	0.1	297.1	808.2	1,105.4	10,922.8

Arrears from mortgage loans used to cover mortgage Pfandbriefe (section 28 (2) no. 2 of the PfandBG):

€ mn	Aggregate payments which are at least 90 days overdue 2019	Total volume of these receivables, to the extent that the relevant amount overdue is not less than 5% of the receivable 2019	Aggregate payments which are at least 90 days overdue 2018	Total volume of these receivables, to the extent that the relevant amount overdue is not less than 5% of the receivable 2018
Germany	0.1	-	0.1	0.2
<b>Total</b>	<b>0.1</b>	<b>-</b>	<b>0.1</b>	<b>0.2</b>

No registered Mortgage Pfandbriefe were surrendered to lenders as collateral for borrowings.

**Additional disclosures on mortgage receivables (section 28 (2) no. 4 of the PfandBG):**

In the financial year 2019, the bank did not acquire any properties for the purpose of loss prevention (2018: none).

As at 31 December 2019, there were four foreclosures and no forced administration procedures pending, and no foreclosures had been carried out (2018: one foreclosure).

As at 31 December 2019, interest payments were overdue in the amount of € 0.8 million (2018: € 1.9 million) for commercial property, and in the amount of € 0.6 million (2018: € 0.1 million) for residential property.

## (47) Contingencies

By means of a Letter of Comfort in favour of the Monetary Authority of Singapore, Aareal Bank AG has undertaken to ensure that Aareal Bank Asia Ltd. is able to fulfil its obligations at any time.

## (48) Events after the reporting date

On 17 February 2020, the ECB granted its permission to Aareal Bank to call the AT1 bond without any replacing new issue. Since that date, Aareal Bank deducts the AT1 bond from regulatory capital as required by the EZB by reference to Art. 28(2) of Commission Delegated Regulation (EU) No. 241/2014 as a result of the possibility to call the bond at any time. The bond has not been called on the date when the financial statements were prepared.

There were no other material events after the reporting period which would have to be reported here.

## (49) Additional disclosures to the Remuneration Report

### Management Board

In the financial year 2019, the Management Board's total remuneration amounted to € 11.2 million (2018: € 9.7 million), of which € 5.2 million (2018: € 4.8 million) referred to variable components. Payments to former Management Board members and their surviving dependants totalled € 2.3 million in 2019 (2018: € 3.0 million).

### Pensions<sup>1</sup>

€ 000's	2019			2018		
	Pension claims p.a. <sup>2)</sup>	Balance of pension obligations as at 31 Dec 2019	Increase of pension obligations in 2019	Pension claims p.a. <sup>2)</sup>	Balance of pension obligations as at 31 Dec 2018	Increase of pension obligations in 2018
Hermann J. Merkens	371	6,539	1,330	345	5,209	1,114
Marc Hess <sup>3)</sup>	35	557	459	7	98	98
Dagmar Knopek	127	2,602	563	110	2,039	506
Christiane Kunisch-Wolff	75	1,388	535	54	853	366
Thomas Ortmanns	294	5,937	1,023	284	4,914	871
Christof Winkelmann	92	1,609	815	65	795	386
<b>Total</b>	<b>994</b>	<b>18,632</b>	<b>4,725</b>	<b>865</b>	<b>13,908</b>	<b>3,341</b>

<sup>2)</sup> The pension entitlements presented are old-age pensions earned upon retirement as of December 31 of the reporting year at the applicable retirement age based on the grants made by the Bank. To enhance comparability with other disclosures, the overview in the year under review and the previous-year figures were adjusted.

<sup>3)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

Service cost incurred in the 2019 financial year in connection with the pension claims of members of the Management Board totalled € 5.9 million (2018: € 4.6 million). The pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 5.8 million in 2019 (2018: € 4.7 million). The total amount of pension obligations as at 31 December 2019 was € 46.9 million (2018: € 41.1 million). Of that amount, € 28.3 million related to former members of the Management Board and their surviving dependants (2018: € 27.2 million).

### Supervisory Board

The total remuneration of members of the Supervisory Board for the financial year 2019 amounted to € 1.5 million (2018: € 1.5 million). The remuneration for any financial year shall be due and payable one month after the end of the respective financial year.

<sup>1</sup> In contrast to the Remuneration Report, which comprises figures in accordance with IFRSs, the figures shown here are in accordance with German commercial law.

## Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG.

Total remuneration of executives in key positions is analysed below:

€ 000's	1 Jan-31 Dec 2019		1 Jan-31 Dec 2018	
Short-term benefits		8,600		7,349
Post-employment benefits		4,725		3,340
Other long-term benefits		1,548		1,441
Termination benefits		-		-
Share-based remuneration		2,580		2,402
<b>Total</b>		<b>17,453</b>		<b>14,532</b>

Provisions for pension obligations concerning key executives totalled € 18.7 million as at 31 December 2019 (2018: € 13.9 million).

## Disclosures on share-based remuneration

### Valuation model and valuation assumptions

The obligations resulting from share-based payment arrangements as at the balance sheet date correspond to the remuneration granted, discounted to the balance sheet date. The discount period corresponds to the period from the balance sheet date to the earliest exercise or payout date, per plan and per tranche. The discount is based on the Euribor swap rate applicable as at the relevant balance sheet date, depending on the term.

### Amount of cash-settled share-based payment transactions

The total amount of outstanding virtual shares in relation to share-based payment arrangements changed as follows:

	2019	2018
Quantity (number)		
<b>Balance (outstanding) at 1 January</b>	<b>506,498</b>	<b>532,478</b>
granted during the reporting period	196,158	154,448
expired during the reporting period	-	-
exercised during the reporting period	89,336	180,428
<b>Balance (outstanding) at 31 December</b>	<b>613,320</b>	<b>506,498</b>
of which: exercisable	-	-

The fair value of the virtual shares granted during the reporting period amounted to € 5.6 million (2018: € 4.2 million) as at the balance sheet date.

The virtual shares exercised during the reporting period were converted at a weighted average price of the Aareal Bank AG share of € 28.69 (2018: € 39.08).

### Impact on financial performance

The total amount expensed for share-based payment transactions in relation to members of the Management Board was € 3.4 million during the financial year 2019 (2018: € 0.1 million). The breakdown amongst the members of the Management Board is shown below:

€	2019	2018
Hermann J. Merkens	820,318	-157,261
Marc Hess <sup>1)</sup>	395,408	100,822
Dagmar Knopek	564,712	-176,781
Christiane Kunisch-Wolff	466,764	122,941
Thomas Ortmanns	574,412	-155,427
Christof Winkelmann	435,043	159,461

<sup>1)</sup> Marc Hess was appointed to the Management Board on 1 October 2018.

In addition, € 0.1 million (2018: € -0.4 million) was expensed for former members of the Management Board.

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 0.0 (2018: € 0.0), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2019 amounted to € 22.5 million (2018: € 21.3 million). It is reported in the statement of financial position in the line item "Provisions".

### (50) Employees

The average staffing level is shown below:

	1 Jan-31 Dec 2019	1 Jan-31 Dec 2018
Yearly average		
Salaried employees	869	870
Executives	36	39
<b>Total</b>	<b>905</b>	<b>909</b>
of which: part-time employees	180	190

### (51) Auditors' fees

Regarding the fees paid to external auditors of Aareal Bank AG, please refer to the Group Annual Report, where individual services provided to Aareal Bank AG and its subsidiaries are outlined as follows:

Other assurance services include the review in accordance with the German Securities Trading Act (WpHG), the bank levy, software confirmations, comfort letters and the separate non-financial statement. Tax advisory services relate to general tax advice rendered. Other services include, in particular, due diligence services and regulatory advice.

### (52) Disclosures pursuant to section 160 (1) no. 8 of the AktG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the Company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification requirement is 3%. 100% of Aareal Bank AG shares are held in free float.

As at 31 December 2019, we were aware of the following shareholders holding a share in the voting rights of at least 3% pursuant to section 33 (1) of the WpHG:

	Location	Total <sup>1)</sup>	Threshold reached on (according to notification)
<b>Responsible entity</b>			
DEKA	Frankfurt	9.60%	22 May 2018
BlackRock	Wilmington	9.51%	23 December 2019
VBL <sup>2)</sup>	Karlsruhe	6.50%	3 February 2015
Dimensional Fund	Austin	5.25%	30 August 2019
iShares Trust <sup>3)</sup>	Wilmington	5.22%	3 April 2019
Igor Kuzniar	Zug	5.07%	10 December 2019
Teleios Global Opportunities Master Fund Ltd. <sup>4)</sup>	George Town	5.07%	10 December 2019
Allianz Global Investors	Frankfurt	4.99%	2 October 2019
JPMorgan Investment Management Inc. <sup>5)</sup>	Wilmington	3.07%	13 November 2018
JPMorgan Chase Bank <sup>5)</sup>	Columbus	3.07%	13 November 2018
JPMorgan Asset Management (UK) <sup>5)</sup>	London	3.07%	13 November 2018
State of Norway (through Norges Bank)	Oslo	3.05%	26 February 2018
DFA International Small Cap Value <sup>6)</sup>	Baltimore	3.01%	7 August 2018

<sup>1)</sup> Direct and indirect holdings of voting rights

<sup>2)</sup> Shares are managed by Deka and are therefore included in DEKA's holding of 9.60%.

<sup>3)</sup> Shares are also attributed to BlackRock and are therefore included in BlackRock's holding of 9.51%.

<sup>4)</sup> Shares are also attributed to Igor Kuzniar and therefore correspond to his share of voting rights.

<sup>5)</sup> The holdings are attributed to each other across these three companies. Therefore, the overall share is 3.07%.

<sup>6)</sup> Shares are also attributed to Dimensional Fund and are therefore included in Dimensional Fund's holding of 5.25%.

### **(53) Declaration of Compliance in accordance with Section 161 of the AktG**

The Management Board and the Supervisory Board issued the Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders. It is available to the public on the Company's website on <https://www.aareal-bank.com/en/about-us/corporate-governance/declaration-of-compliance/>.

### **(54) Proposal on the appropriation of profits**

The Management Board of Aareal Bank AG proposes to the Annual General Meeting that the net retained profit of € 119,714,442.00 for the financial year 2019, as reported under the German Commercial Code (HGB), be used to distribute a dividend. With 59,857,221 notional no-par value shares outstanding, this translates into a dividend of € 2.00 per share.

**(55) Executive bodies of Aareal Bank AG****Offices held in accordance with section 285 no. 10 of the German Commercial Code (HGB) in conjunction with section 125 (1) sentence 5 of the German Public Limited Companies Act (AktG)****Supervisory Board****Marija Korsch, Chairman of the Supervisory Board****Former partner of Bankhaus Metzler seel. Sohn & Co. Holding AG**

Aareal Bank AG	Chairman of the Supervisory Board
Just Software AG	Member of the Supervisory Board
Nomura Financial Products Europe GmbH	Member of the Supervisory Board

**(Offices held with other listed companies)**

Instone Real Estate Group N.V.	Member of the Supervisory Board
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**(Non-commercial mandates)**

FAZIT – Stiftung Gemeinnützige Verlagsgesellschaft mbH	Shareholder and member of the Advisory Board
Städelsches Kunstinstitut und Städtische Galerie	Member of the Administration
Gesellschaft der Freunde der Alten Oper Frankfurt e.V.	Deputy Chairman of the Management Board
Stiftung Centrale für private Fürsorge	Chairman of the Foundation's Executive Board

**Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board****Businessman; former spokesman of the General Partners of Bankhaus Lampe KG**

Aareal Bank AG	Deputy Chairman of the Supervisory Board
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board
HANSAINVEST (Hanseatische Investment-GmbH)	Member of the Supervisory Board
Merica Holdings Plc Ltd.	Member of the Board of Directors

**(Non-commercial mandates)**

hsh portfoliomanagement AöR	Member of the Board of Directors	(since 1 January 2019)
SC Preußen Münster 06 GmbH	Member of the Board of Directors	(until 10 October 2019)

**Klaus Novatius\*, Deputy Chairman of the Supervisory Board****Aareal Bank AG**

Aareal Bank AG	Deputy Chairman of the Supervisory Board	(since 1 January 2019)
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**Thomas Hawel\*****Aareon Deutschland GmbH**

Aareal Bank AG	Member of the Supervisory Board
Aareon Deutschland GmbH (office held with Aareal Bank Group)	Deputy Chairman of the Supervisory Board

**Petra Heinemann-Specht\*****Aareal Bank AG**

Aareal Bank AG	Member of the Supervisory Board
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\* Employee representative member of the Supervisory Board of Aareal Bank AG



**Richard Peters****President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder**

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH (liquidation planned)	Member of the Supervisory Board (not active)	(until 15 February 2019)

**(Non-commercial mandates)**

VBLU e.V.	Chairman of the Management Board	
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**Dr Hans-Werner Rhein****German Lawyer (Rechtsanwalt)**

Aareal Bank AG	Member of the Supervisory Board	
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**(Offices held with other listed companies)**

Deutsche Familienversicherung AG	Chairman of the Supervisory Board	
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**(Non-commercial mandates)**

Müller-Matthieu Stiftung	Chairman of the Management Board	
ARIAS Deutschland e.V.	Chairman of the Management Board	
St. Petri Stiftung, Hamburg	Member of the Management Board	

**Sylvia Seignette****Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)**

Aareal Bank AG	Member of the Supervisory Board	
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**Elisabeth Stheeman****External Member of the Financial Policy Committee and the Financial Market Infrastructure Board, Bank of England, Prudential Regulation Authority**

Aareal Bank AG	Member of the Supervisory Board	
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**(Offices held with other listed companies)**

Edinburgh Investment Trust Plc	Member of the Board of Directors	(since 23 May 2019)
Korian SA	Member of the Supervisory Board	(until 6 June 2019)

**Hans-Dietrich Voigtländer****Associate Partner at BDG Innovation + Transformation GmbH & Co. KG**

Aareal Bank AG	Member of the Supervisory Board	
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**Prof. Dr Hermann Wagner, Chairman of the Audit Committee****German Chartered Accountant, tax consultant**

Aareal Bank AG	Member of the Supervisory Board	
btu beraterpartner Holding AG	Member of the Supervisory Board	
Squadra Immobilien GmbH & Co. KgaA	Member of the Supervisory Board	

**(Offices held with other listed companies)**

PEH Wertpapier AG	Member of the Supervisory Board	
Consus Real Estate AG ("Scale" segment of the Regulated Unofficial Market)**	Member of the Supervisory Board	

**Beate Wollmann\*****Aareon Deutschland GmbH**

Aareal Bank AG	Member of the Supervisory Board	
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\* Employee representative member of the Supervisory Board of Aareal Bank AG

\*\* Banking supervisory authority has approved the acceptance of this fifth Supervisory Board office in accordance with section 25d (3) of the KWG.

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### Composition of Supervisory Board committees

#### Executive and Nomination Committee

Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Klaus Novatius	Deputy Chairman
Richard Peters	
Dr Hans-Werner Rhein	

#### Technology and Innovation Committee

Hans-Dietrich Voigtländer	Chairman
Marija Korsch	Deputy Chairman
Thomas Hawel	
Richard Peters	
Elisabeth Stheeman	

#### Audit Committee

Prof. Dr Hermann Wagner	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Marija Korsch	
Richard Peters	
Hans-Dietrich Voigtländer	
Beate Wollmann	

#### Remuneration Control Committee

Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Klaus Novatius	Deputy Chairman
Hans-Dietrich Voigtländer	

#### Risk Committee

Sylvia Seignette	Chairman
Elisabeth Stheeman	Deputy Chairman
Petra Heinemann-Specht	
Marija Korsch	
Dr Hans-Werner Rhein	
Prof. Dr Hermann Wagner	

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## Management Board

### Hermann Josef Merkens, Chairman of the Management Board

Corporate Strategy, Project & Credit Portfolio Management, Corporate Communications,  
Investor Relations incl. Sustainability, Board Office, Human Resources, Legal, Audit

Becker & Kries family foundation	Member of the Board of Trustees	(since 9 June 2019)
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#### (Offices held at companies of Aareal Bank Group)

Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Capital Corporation	Chairman of the Board of Directors	
Aareon AG	Deputy Chairman of the Supervisory Board	
Aareal Beteiligungen AG (formerly Corealcredit Bank AG)	Chairman of the Supervisory Board	

### Marc Hess, Member of the Management Board

Finance & Controlling, Treasury

#### (Offices held at companies of Aareal Bank Group)

Aareon AG	Member of the Supervisory Board	(since 1 January 2019)
Düsseldorfer Hypothekenbank AG	Chairman of the Supervisory Board	(until 24 June 2019)

### Dagmar Knopek, Member of the Management Board

Credit Management, Workout and Operations

HypZert GmbH	Chairman of the Supervisory Board	
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#### (Offices held at companies of Aareal Bank Group)

Düsseldorfer Hypothekenbank AG	Member of the Supervisory Board	(until 24 June 2019)
Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Chairman of the Supervisory Board	(until 7 March 2019)

### Christiane Kunisch-Wolff, Member of the Management Board

Risk Controlling, Regulatory Affairs and Compliance

#### (Offices held at companies of Aareal Bank Group)

Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Member of the Supervisory Board	(until 7 March 2019)
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### Thomas Ortmanns, Member of the Management Board

Housing Industry, Information Technology and Organisation

#### (Offices held at companies of Aareal Bank Group)

Aareon AG	Chairman of the Supervisory Board	
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### Christof Winkelmann, Member of the Management Board

Sales Unit Structured Property Financing

#### (Offices held at companies of Aareal Bank Group)

Aareal Bank Asia Limited	Chairman of the Board of Directors	
Aareal Capital Corporation	Member of the Board of Directors	
La Sessola Service S.r.l.	Member of the Management Board	
La Sessola S.r.l.	Member of the Management Board	

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## Responsibility statement

To the best of our knowledge, and in accordance with the applicable reporting principles for financial reporting, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the management report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal opportunities and risks associated with the expected development of the Company.

Wiesbaden, 2 March 2020

### The Management Board



Hermann J. Merkens



Marc Hess



Dagmar Knopek



Christiane Kunisch-Wolff



Thomas Ortmanns



Christof Winkelmann

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# Independent Auditors' Report

**To Aareal Bank AG, Wiesbaden**

## **Report on the Audit of the Annual Financial statements and the management report**

### **Audit Opinions**

We have audited the annual financial statements of Aareal Bank AG, Wiesbaden, which comprise the balance sheet as at December 31, 2019, and the statement of profit and loss for the financial year from January 1 to December 31, 2019, and notes to the financial statements, including the presentation of the recognition and measurement policies. In addition, we have audited the management report of Aareal Bank AG for the financial year from January 1 to December 31, 2019. In accordance with the German legal requirements, we have not audited the content of those parts of the management report listed in the "Other Information" section of our auditor's report.

In our opinion, on the basis of the knowledge obtained in the audit,

- ◆ the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law and give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2019, and of its financial performance for the financial year from 1 January to 31 December 2019, in compliance with German Legally Required Accounting Principles, and
- ◆ the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the content of those parts of the management report listed in the "Other Information" section of our auditor's report.

Pursuant to § (Article) 322 Abs. (paragraph) 3 Satz (sentence) 1 HGB (Handelsgesetzbuch: German Commercial Code), we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

### **Basis for the Audit Opinions**

We conducted our audit of the annual financial statements and of the management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and on the management report.

### **Key Audit Matters in the Audit of the Annual Financial Statements**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from 1 January to 31 December 2019. These matters were addressed in the context of our audit of the annual financial statements as a whole and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

- ① Recoverability of the Italian mortgage loan portfolio
- ② Recoverability of properties acquired from previous loan exposures, as indirectly reported under "Investments in affiliated companies" in the balance sheet
- ③ Implementation of SAP S/4HANA software to handle business processes in the core banking business and accounting

Our presentation of these key audit matters has been structured in each case as follows:

- ① Matter and issue
- ② Audit approach and findings
- ③ Reference to further information

Hereinafter we present the key audit matters:

#### ① **Recoverability of the Italian mortgage loan portfolio**

- ① In the annual financial statements of Aareal Bank AG, loans and advances to customers in the amount of € 2.1 billion that are secured by properties in Italy (hereinafter "Italian mortgage loan portfolio") are reported as of 31 December 2019. Italy's difficult macroeconomic situation has in past years led, in part, to financial difficulties and restructuring proceedings for Aareal Bank AG's borrowers. The realization of the properties on which the Italian mortgage loan portfolio is based has taken a number of years so far depending on their size, location and type. Aareal Bank AG analyzes the financial circumstances of borrowers using, inter alia, the annual financial statements, business plans and rent rolls provided, and generally reviews the market values of the corresponding collateral at least once a year. In the majority of cases, Aareal Bank AG obtains external valuations to determine the market values of the properties used as collateral. Property market values are calculated by appraisers in each case as the present values of future cash flows using the discounted cash flow method, with the appraisers deriving the assumptions about future cash flows that can be generated by the property using the information and business plans provided by the borrowers, or determined on the basis of floor area-related comparative values. If it is found when assessing the borrower that there has been a default and the income from collateral is expected to be insufficient, the Company applies a specific valuation allowance. When determining the risk allowances for the Italian mortgage loan portfolio, the executive directors make assumptions concerning cash flow, completion and realization as well as assumptions concerning the probability of scenarios. Since even relatively small changes in these assumptions have a significant influence on the associated collateral value and the measurements of the loans and advances are subject to uncertainties in this regard, this matter was of particular significance in the context of our audit.
- ② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances of the lenders and the recoverability of the used collateral in a risk-focused sample of exposures. We evaluated the valuations performed by the appraisers and their review by Aareal Bank AG in terms of their suitability, up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations and their review by Aareal Bank AG were based, evaluated these critically and assessed whether they were within a justifiable range. In some cases, we carried out our own property inspections. In addition, we based our assessment of the executive directors' assumptions concerning cash flow, completion and realization on general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash inflows and outflows as well as assumptions concerning the probability of scenarios. Furthermore, we examined the relevant credit processes within the Aareal Bank AG's internal control terms of the appropriateness of their design and tested their effectiveness. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the Italian mortgage loan portfolio and the procedures implemented are appropriate.

- ③ With respect to the allowance for credit losses, in this context please refer to the disclosures on loans and advances in the section "Accounting and valuation principles" in the notes to the financial statements. These also contain information on the allowance for credit losses for the Italian real estate lending portfolio.

**② Recoverability of properties acquired from previous loan exposures, as indirectly reported under "Investments in affiliated companies" in the balance sheet**

- ① In the annual financial statements of Aareal Bank AG, € 302 million in properties acquired from previous loan exposures held as real estate special purpose entities were reported indirectly under the "Investments in affiliated companies" balance sheet item as of 31 December 2019. Investment management at Aareal Bank AG tests the investments for impairment at each balance sheet date. This includes impairment testing on the properties acquired from previous loan exposures, which is carried out at least once a year on the basis of external valuations. The market values of the properties are calculated in each case as the present values of the expected future cash flows using the discounted cash flow method, with the appraisers using the information and planning projections provided by the executive directors to derive assumptions about the future cash flows, or on the basis of floor area-adjusted comparative values. In addition, the executive directors make assumptions about completion, leasing and marketing. Since even small changes in these assumptions have a significant influence on the market values of the properties and consequently the carrying amount of the investment, and that the measurements are thus subject to uncertainties, this matter was of particular significance in the context of our audit.

- ② As part of our audit, we particularly evaluated the valuations performed by the external appraisers in terms of their up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In this context we involved our own real estate experts. In addition, we based our assessment of the cash flow, leasing and marketing assumptions made by the executive directors on, inter alia, a comparison with general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash flows. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the properties reported under the "Investments in affiliated companies" balance sheet item acquired from former exposures are appropriate.

- ③ Please refer to the disclosures on investments in affiliated companies, which can be found in the section entitled "Accounting and valuation principles" in the notes to the financial statements.

**③ Implementation of SAP S/4HANA software to handle business processes in the core banking business and accounting**

- ① Aareal Bank AG processes a significant amount of its accounting-related data using IT applications based on software developed by SAP SE, Walldorf. The applications are used in particular to handle business processes in the core banking business (including to manage loans and collateral), for accounting (ongoing recording of business transactions in subledgers and in the general ledger and preparing the annual financial statements) and for management accounting.

As part of its strategy to modernize and harmonize its IT architecture, Aareal Bank AG resolved a changeover to the new SAP product generation, S/4HANA. In the course of defined project phases, a new SAP system with system configuration adapted to current requirements (customizing) was successively set up on the basis of the existing SAP system from the fourth quarter of 2018. Defined datasets were migrated from the old to the new SAP system at the end of November 2019.

The implementation of SAP S/4HANA was of particular significance in the context of our audit due to the key role of the SAP system for the handling of processes in the core banking business and for the financial accounting system and thus for the functioning of the control and accounting processes and the legal compliance of the annual financial statements.

- ② As part of our audit, we first obtained an understanding of the objectives, organization, scheduling and project management of the implementation project. On this basis, we assessed the appropriateness of the functional and technical concept based on what we considered to be the most import-

ant documents. In addition, during the project we assessed whether the test plan was appropriate and complete. We verified, on a sample basis, that testing was properly carried out and documented and that test results were taken into appropriate consideration within the various test phases (functional and integration tests). Furthermore, we assessed the appropriateness of the data migration concepts and the proper performance and documentation of the data migration. This involved, among other things, verifying the appropriateness of the reconciliation activities performed by the Company as of the data migration date, including tracking abnormalities. In addition, we inspected the approvals of the Company's involved departments and verified whether the approvals required for going live had been granted.

We also assessed the design and operating effectiveness of selected controls put in place to ensure proper data processing during ongoing operations. As part of our audit, we also evaluated the report prepared by Internal Audit on its audit carried out in connection with the implementation of SAP S/4HANA.

Based on our audit procedures, we were able to satisfy ourselves overall that the SAP S/4HANA software was properly implemented in a comprehensible manner.

- ③ The Company's disclosures relating to the implementation of SAP S/4HANA are contained in section "Organization of the accounting-related ICS and RMS" in the management report.

### Other Information

The executive directors are responsible for the other information. The other information comprises the following non-audited parts of the management report:

- ◆ the statement on corporate governance pursuant to § 289f HGB and § 315d HGB included in section "Corporate Governance Statement" of the management report
- ◆ the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB

The other information comprises further the remaining parts of the annual report – excluding cross-references to external information – with the exception of the audited annual financial statements, the audited management report and our auditor's report.

Our audit opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- ◆ is materially inconsistent with the annual financial statements, with the management report or
- ◆ our knowledge obtained in the audit, or
- ◆ otherwise appears to be materially misstated.

### Responsibilities of the Executive Directors and the Supervisory Board for the Annual Financial Statements and the Management Report

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, the executive directors are responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.



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In preparing the annual financial statements, the executive directors are responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, the executive directors are responsible for the preparation of the management report that as a whole provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

### **Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report**

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation, and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- ◆ Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- ◆ Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems of the Company.
- ◆ Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- ◆ Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the

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date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.

- ◆ Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.
- ◆ Evaluate the consistency of the management report with the annual financial statements, its conformity with German law, and the view of the Company's position it provides.
- ◆ Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards. From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

## **Other Legal and Regulatory Requirements**

### **Further Information pursuant to Article 10 of the EU Audit Regulation**

We were elected as auditor by the annual general meeting on 22 May 2019. We were engaged by the supervisory board on 25 June 2019. We have been the auditor of Aareal Bank AG, Wiesbaden, and its legal predecessors without interruption since the financial year 1976.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

## **German Public Auditor Responsible for the Engagement**

The German Public Auditor responsible for the engagement is Christian F. Rabeling.

Frankfurt/Main, 3 March 2020

**PricewaterhouseCoopers GmbH**  
**Wirtschaftsprüfungsgesellschaft**

(sgd. Ralf Schmitz)  
Wirtschaftsprüfer  
(German Public Auditor)

(sgd. Christian F. Rabeling)  
Wirtschaftsprüfer  
(German Public Auditor)

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## Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

### Dear shareholders,

Aareal Bank has confronted the various challenges in the financial year 2019 and can look back at another successful financial year in which the Bank not only generated good results, but also set the strategic course for the future. All targets were achieved in the past financial year, whilst further improving the foundations for a continuation of its positive performance over the past years. The Supervisory Board believes that Aareal Bank remains in very good shape today and is ideally equipped to meet the challenges that lie ahead.

During the financial year under review, the Supervisory Board continually advised, monitored, and supervised the management of the Company. The Management Board informed the Supervisory Board regularly, without delay and comprehensively about all the issues important to the Bank. The Management Board reported on the Group's situation, business development, key financial indicators and market developments. In addition, detailed reports and explanations were given to the Supervisory Board regarding the current liquidity status and liquidity management measures taken, the prevailing risk situation, and on risk control and risk management measures taken within the Group. The Supervisory Board was also informed about compliance within the Company on a regular basis, and it received the reports prepared by Internal Audit. The Supervisory Board also received comprehensive reports on the development of the business segments, and on operative and strategic planning, and was involved in all material decisions of Aareal Bank Group. All material events were discussed and examined in detail; where a Supervisory Board resolution was required, the decision proposals were submitted to the Supervisory Board in due time, and a decision taken. In cases where resolutions needed to be passed in periods between scheduled Supervisory Board meetings, such resolutions were passed by way of circulation or via conference calls.

Furthermore, between the meetings of the Supervisory Board, the Chairman of the Management Board kept the Chairman of the Supervisory Board informed, on a continuous and regular basis, on all material developments of the Company. The Chairman of the Management Board maintained close contact with the Chairman of the Supervisory Board, in order to discuss key issues and important decisions personally. The Chairman of the Supervisory Board then proceeded to inform the other Supervisory Board members of these discussions at the following Supervisory Board meetings.

### Activities of the Plenary Meeting of the Supervisory Board

Nine plenary meetings of the Supervisory Board were held in the year under review. During these meetings, the members of the Supervisory Board received reports and explanations from the members of the Management Board, and discussed these in detail. Market developments, also considering the persistent geopolitical changes, the large number of regulatory adjustments that are yet required and further progress in implementing the "Aareal 2020" programme for the future as well as designing the successor programme "Aareal Next Level" were focal points of the work and reporting in all scheduled meetings.

Throughout the financial year, in the course of all meetings as well as during the periods between meetings, the Management Board informed the Supervisory Board about economic and market developments and their potential impact on Aareal Bank Group, in a timely, complete and comprehensible manner. This also included the measures the Bank had taken in response to the general market developments and the conditions prescribed by monetary policy. During the plenary meetings of the Supervisory Board, the Management Board reported to the Supervisory Board regularly and comprehensively; these reports also covered the development of the Structured Property Financing and Consulting/Services segments, focusing on current economic developments. In addition, the Supervisory Board was informed about the business development of the entire Aareal Bank Group. At regular intervals, the Supervisory Board was informed of the Bank's liquidity status and the related steps taken by the Bank's Treasury division. The Management Board also reported regularly on the quality of the property financing portfolio against the background of general market trends and expected changes on the various property markets. Within the scope of reporting, the regular reports prepared by the control functions – including Risk Controlling, Compliance, Internal Audit, Information Security & Data Protection, the Remuneration Officer, and Human Resources – were

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presented and discussed. At each plenary meeting of the Supervisory Board, the committee chairmen reported on the committee meetings that had taken place in the meantime.

The focal points of the individual meetings are outlined below.

During its January meeting, the Supervisory Board dealt with the Bank's dividend policy, the individual Management Board members' target achievement in the past financial year, and target setting for the new financial year. The dividend policy discussion was continued at a meeting in February, during which different scenarios of a potential dividend distribution were presented to the Supervisory Board, and were subsequently reviewed and assessed by the Supervisory Board.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2018 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. Furthermore, the Supervisory Board discussed the non-financial report 2018 and the results of the audit going hand in hand with it, to obtain limited assurance. Another issue covered during the March meeting included preparations for the Annual General Meeting in May 2019. This comprised the decision proposals regarding the agenda of the Annual General Meeting, including the proposal for the appropriation of profit and the proposal regarding the selection of external auditors. The annual report submitted by Internal Audit, and their audit planning for the upcoming financial year as well as their mid-term plans were also discussed during the meeting. In addition, the Supervisory Board resolved the revised Code of Conduct which also applies to the executive bodies, and concerned itself with the remuneration systems for the employees and the Management Board members; it came to the conclusion that the Company's remuneration systems are adequate.

The May meeting commenced with a detailed review of the Annual General Meeting of Aareal Bank AG, which preceded the meeting. Furthermore, the Management Board presented its regular detailed reporting on current and expected business developments, which the Supervisory Board discussed. This meeting also discussed the annual report submitted by the Compliance Officer. The Supervisory Board also agreed with the Audit Committee's proposal regarding the focal audit points set by the Supervisory Board for the audit of the financial statements for the 2019 financial year.

The two-day Supervisory Board meeting in June was held to comprehensively discuss Aareal Bank Group's current strategy implementation and refinements thereon, as well as to hear the Management Board's regular reporting. The Supervisory Board talked about the presented strategic initiatives and options with the Management Board in considerable depth and detail. Within this context, adjustments made to material risk documents were also presented and discussed.

During the September meeting, current questions concerning strategic initiatives were presented and discussed, in addition to the regular reports. This meeting took place at Aareon AG's headquarters in Mainz, which is why Aareon Group's further development was the main topic. On the one hand, the Supervisory Board discussed Aareon AG's new Management Board structure and its assignment of responsibilities with the Management Boards of Aareal Bank AG and Aareon AG. Strategic targets and growth areas at Aareon Group were also presented and discussed. On the other hand, the Supervisory Board of Aareal Bank AG was informed about the planned acquisition of CalCon Group, the purchase of which it agreed to after an in-depth review.

Furthermore, the company retirement provision system for Management Board members was adjusted based on a recommendation made by the Remuneration Control Committee (for details, please refer to the Remuneration Report > Remuneration of the Management Board 2019). Since this was only a harmonisation of the company retirement provisions, the Supervisory Board assessed this amendment as non-material, hence deeming a submission to the Annual General Meeting (by means of a so-called say-on-pay resolution) to be unnecessary for this purpose. The resolution on the remuneration system for the Management Board and the Supervisory Board is planned to be proposed to the Annual General Meeting in the year 2021. Until that time, various questions need to be addressed as regards the interpretation and compatibility of the new recommendations of the German Corporate Governance Code and the very strict German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – InstVergV).

At two meetings in October and November, the Supervisory Board asked the Management Board to report on the initiative of an investor regarding the disposal of the subsidiary Aareon. The further development of Aareon Group, and particularly the various opportunities to enhance its growth, was the topic of discussion at numerous Supervisory Board meetings, both within the Executive and Nomination Committee and in the plenary meeting of the Supervisory Board. The Supervisory Board supports the respective details communicated by the Management Board and its initiatives.

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At the December meeting, the Management Board presented the strategies pursuant to the Minimum Requirements for Risk Management ("MaRisk") and the Group's corporate planning in detail. According to their respective responsibilities, the strategies had previously been presented to the Executive and Nomination Committee, the Risk Committee, and the Audit Committee, and finally to the Supervisory Board, to subsequently be discussed with the Management Board in depth. Another issue to be discussed was preparing the Corporate Governance Report, including the Corporate Governance Statement and the Declaration of Compliance. The latter was resolved and subsequently published on Aareal Bank AG's website. Furthermore, the annual review was carried out concerning Rules of Procedure for the Management Board and Supervisory Board, the individual and collective suitability and efficiency of the Management Board and Supervisory Board (annual evaluation), the review processes, and the Conflict of Interest Policy for members of the Company's executive bodies. The Supervisory Board discussed the results of the evaluation in detail and will incorporate the findings into its work. The Supervisory Board also concerned itself with the Management Board's preliminary target achievement 2019 and with deriving the Management Board targets for 2020 in accordance with the strategy presented. At its December meeting, the Supervisory Board also discussed the Audit Committee's proposal for new external auditors, which the Committee had submitted based on the selection procedure carried out for the change in external auditors from the 2021 financial year. After intensive discussions, the Supervisory Board followed the Audit Committee's proposal and will propose to the Annual General Meeting 2020 that either KPMG AG Wirtschaftsprüfungsgesellschaft or Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft be appointed as external auditors to review, if applicable, any additional financial information required, within the meaning of section 115 (7) of the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG"), during the 2021 financial year, until the next Annual General Meeting. Furthermore, it is also planned to propose to the Annual General Meeting that either KPMG AG Wirtschaftsprüfungsgesellschaft or Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft be appointed external auditors of the annual and consolidated financial statements for the 2021 financial year. In line with the recommendation of the Audit Committee, the Supervisory Board has a preference for KPMG AG Wirtschaftsprüfungsgesellschaft in each case.

At its December meeting, the Supervisory Board also resolved – based on the Executive and Nomination Committee's recommendation – to renew the term of office of Marc Hess as member of the Management Board for a period of five years, after he had resigned from his position in agreement with the Supervisory Board. The Supervisory Board mainly based its decision on the fact that Mr Hess had become acquainted with his tasks extraordinarily quickly, providing valuable impetus for Aareal Bank's further strategic and financial development already in the first year of his term of office. Especially against the backdrop of the challenges lying ahead, such as the demanding market and competitive environment, it is of utmost importance for Aareal Bank to attract qualified leaders like Mr Hess, and to retain them for the long term, thus assuring continuity in the Management Board team.

The chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting, answering all related questions submitted by the members of the plenary meeting in detail.

To the extent that any Supervisory Board decisions were taken by way of circulation, the Supervisory Board received a report by the Management Board on the implementation of such decisions taken previously, at the subsequent Supervisory Board meeting.

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. No potential conflicts of interest that would need to be considered in the context of decision-making processes were identified during the financial year under review.

## **Activities of Supervisory Board Committees**

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Risk Committee, the Audit Committee, the Remuneration Control Committee, and the Technology and Innovation Committee.

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## **Executive and Nomination Committee:**

The Executive and Nomination Committee of the Supervisory Board convened for six meetings in the year under review. The Committee prepared the plenary meetings of the Supervisory Board in all its meetings and discussed Aareal Bank Group's strategic development with the Management Board at regular intervals. Regarding the agenda items within the responsibility of the Supervisory Board, the Committee convened without the Management Board. These meetings particularly included discussions regarding suitability requirements for Management Board and Supervisory Board members, the processes for reviewing these requirements, the targets for the composition of both executive bodies, and the results of the annual evaluation of Management Board and Supervisory Board.

In the January 2019 meeting, the Executive and Nomination Committee concerned itself with the Company's dividend policy.

The March meeting was held in order to prepare for the Annual General Meeting in May 2019. This comprised the decision proposals regarding the agenda of the Annual General Meeting. The Committee also concerned itself with the annual potential Management Board and Supervisory Board appointments in the next financial year, and thus with the topic of succession planning. Another meeting held in March was focused on personnel issues below the Management Board.

The June 2019 meeting was used to prepare for the Supervisory Board's strategy meeting, and an intense discussion as regards succession planning for the Management Board. Another topic handled was the resolution of the Supervisory Board's Rules of Information in the internal framework, which governs Management Board reporting to the committees and the Supervisory Board plenary. In conjunction with this matter, the Rules of Procedure of Management Board and Supervisory Board were amended.

The Executive and Nomination Committee meeting in September 2019 was held to prepare for this year's evaluation and the selection of external auditors to this end. In addition, the strategy dialogue for the second half of the year 2019 was discussed. Other issues in the meeting's focus were the current corporate governance developments, including implementation of the new German Corporate Governance Code ("GCGC") and of the Bill to Implement the Second EU Shareholder Rights Directive ("ARUG II"). As proposed by the GCGC, the Chairman of the Supervisory Board held an appropriate number of talks with investors in the year under review, exchanging views on Aareal Bank's corporate governance and informing Board members concerning the contents of these talks in subsequent meetings (see "Shareholder communication" below for details on the topics).

At the December 2019 meeting, the Executive and Nomination Committee carried out the annual review of the Rules of Procedure for the Management Board and Supervisory Board, the individual and collective suitability and efficiency of the Management Board and Supervisory Board (annual evaluation), the respective review processes, and the Conflict of Interest Policy for members of the Company's executive bodies, also considering the results of the written query directed at all Management Board and Supervisory Board members regarding potential conflicts of interest in the past financial year. The members of the Management Board and Supervisory Board have declared in writing that no conflicts of interest within the meaning of the German Corporate Governance Code arose during the financial year under review.

In addition, the Executive and Nomination Committee proposed to recommend to the Supervisory Board the re-appointment of Marc Hess for five years after his amicable resignation (please refer to the Activities of the Plenary Meeting of the Supervisory Board above).

## **Risk Committee:**

The Risk Committee held six meetings during the year under review. It regularly discussed reports on the Bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the Committee. Besides credit and country risks, the Committee concerned itself with market risks, liquidity risks, and operational risks, as well as reputational and IT risks. The Committee was also engaged with the analysis of Aareal Bank's risk-bearing capacity and its capital ratios. Also, detailed reports were provided regarding the Bank's liquidity status and management as well as its funding. Risks from existing investments, as well as all additional material risks were also presented.

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The Risk Committee concerned itself with Aareal Bank's strategies and the derived sub-risk strategies, as well as with the risk management system. The Management Board also submitted detailed reports to the Risk Committee, covering all markets in which the Bank is active in the property finance business, as well as supplementary reports regarding the Bank's investments in securities portfolios. The Committee members discussed these reports and market views in detail. Within the scope of risk reporting, significant exposures were discussed in detail, and measures for the reduction of high-risk exposures presented and consulted within the Committee. The Risk Committee received a report on recovery planning and other risk management measures, which included preparations for the UK's exit from the EU and corresponding reactions to the current developments. The Management Board also informed the Risk Committee about all completed, ongoing and scheduled audits by the supervisory authorities at each Risk Committee meeting. In addition to regular reporting on the risk situation at each meeting, the following meetings had additional focal points on certain topics:

The Risk Committee meeting held in March 2019 dealt with the results of the risk management system review performed by the external auditors, with focused market reporting, and the supervisory authorities' focus in the 2019 financial year.

In May 2019, the Risk Committee mainly addressed the implementation of regulatory requirements, determining that six meetings per annum would be held in future, so as to allow enough time (especially for regulatory developments) per topic.

In June 2019, individual sub-risk strategies, amended to take account of regulatory requirements, were submitted to the Risk Committee for discussion.

At the September meeting, the Management Board informed the Risk Committee about current recovery planning.

At its December meeting, the Risk Committee discussed all of the Bank's business and risk strategies. The Committee monitored the terms in the client business, based on the business model and risk structure of the Bank, supported the Remuneration Control Committee in evaluating the effects of the remuneration systems on the Bank's risk, capital and liquidity situation, and checked whether the remuneration systems are aligned with the Bank's sustainable development and business strategy. Within this context, the Risk Committee also ensured that the derived risk strategies and the remuneration strategy are in line.

At another meeting in December, the Committee dealt with Aareal Bank AG's IT strategy and IT security strategy as well as with all aspects of the Bank's security management. The Technology and Innovation Committee had been invited to this end. The regulatory requirements for IT security were also discussed.

The Committee also concerned itself with the banking and regulatory environment, focusing on current topics such as individual risk types during individual meetings. Furthermore, the Risk Committee dealt with the audits performed by the supervisory authorities, the findings these audits had yielded, and the authorities' recommendations on risk-related topics.

### **Audit Committee:**

The Audit Committee held six meetings during the year under review.

In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2019, the Audit Committee discussed with the Management Board the quarterly results to be published. Furthermore, the current status and planning of key management indicators in the financial year, and current reviews and projects at Aareal Bank were reported upon at the Audit Committee meetings. In its meetings, the Committee received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations, and duly noting both reports. The Committee was also informed about the work carried out by Internal Audit and of the audit planning. The Head of Internal Audit attended all meetings. The Committee dealt with the measures the Management Board had taken to address the shortcomings identified by external auditors, Internal Audit, and supervisory authorities, and had the Management Board report on the status and progress of the rectification of findings. External auditor representatives, too, attended all meetings, excluding the agenda items regarding the rotation of external auditors, the assessment of financial statements auditing, and the proposal for new external auditors. A regular update on the status of already approved and expected non-auditing services provided by the external auditors was given at all meetings. In anticipation of the 70% limit of approved non-audit services in relation to planned audit services (applicable as of 2020), the Audit Committee had already voluntarily

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resolved to adhere to this threshold in 2018 and 2019. It was neither reached nor exceeded at any time.

At its February 2019 meeting, the preliminary figures for the 2018 financial year were submitted to the Audit Committee, and the dividend policy was discussed. In addition, the annual report 2018 and the audit planning of Internal Audit were presented.

In March 2019, the Committee received the external auditors' report on the audit of the financial and consolidated financial statements for the 2018 financial year, and discussed the results with the auditors in detail. The Committee members discussed the contents of the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of meetings held with the external auditors. Furthermore, the Chairman of the Audit Committee informed the meeting about his discussions with the external auditors outside the meetings. Without the external auditors being present, the Audit Committee discussed the agenda items regarding the assessment of financial statements auditing and the proposal for the external auditors for the 2019 financial year. The Committee also concerned itself with Aareal Bank Group's Sustainability Report and the audit undertaken to obtain limited assurance for this report.

At its meeting in May 2019, the Audit Committee discussed the key points of the Supervisory Board's audit for the 2019 financial year.

At the August 2019 meeting, the Audit Committee concentrated on regulatory developments in sustainable finance, the results of the review of the half-yearly financial report as at 30 June 2019, and on the approach for the audit of the financial and consolidated financial statements.

At its November meeting, the Audit Committee focused on the change in external auditors provisioned by the German Audit Reform Act (Abschlussprüfungsreformgesetz – "AReG"). Furthermore, the Committee prepared the Supervisory Board's informational meeting in December and discussed the risks related to implementing the benchmark guideline. The Audit Committee also resolved that the quarterly planning and forecast calculation in conjunction with quarterly earnings management would take place in the form of plenary meetings in March, June, September and December as of the next financial year. The Management Board had proposed such a change. The meetings held in May, August and November concentrate on the quarterly figures and can be carried out via conference calls.

In addition to a report on the audit progress, the Management Board presented and explained the updated Group planning to the Committee during its December meeting. The Audit Committee was also informed by the Management Board about the structure of sustainability reporting for the 2019 financial year. Furthermore, the Committee was regularly informed about the risk management system and the review of the Internal Control System, in accordance with legal requirements; it duly acknowledged the reports, following discussion.

### **Rotation of external auditors:**

To comply with the provisions set out in Regulation (EU) No. 537/2014 on the obligation to rotate external auditors, Aareal Bank published the procedure for the selection of new external auditors for Aareal Bank AG and Aareal Bank Group for the 2021 financial year via the German Federal Gazette at the beginning of the 2019 financial year. An internal project team at Aareal Bank AG, set up by the Audit Committee, will carry out the selection process. The Audit Committee also resolved the material process steps, selection criteria, and material decisions. It received regular progress reports concerning the procedure, discussing, and if applicable, deciding upon any further steps. The project team comprised the Chairman of the Audit Committee, the Chief Financial Officer, Chief Risk Officer, the member of the Management Board responsible for Credit Management and executives of the divisions primarily concerned. In line with EU provisions, the entire process was designed in a fair, transparent, and non-discriminatory manner. Following the announcement in the German Federal Gazette, auditors were prompted to voice their interest in participating in the selection process. In a next step, the interested parties received comprehensive documentation, enabling them to hand in a substantiated written tender. Following the expression of interest, the candidates were given the opportunity to resolve unanswered questions in the next phase. The project team and the Chairman of the Audit Committee then analysed and assessed the tenders subsequently submitted in writing, selected the four candidates fulfilling most of the criteria determined by the Audit Committee, and invited these contenders to present their tender and introduce the most important team members in person. All members of the project team attended these presentations. Based on assessment of the presentations, the team narrowed the selection to two candidates, KPMG AG Wirtschaftsprüfungs-



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gesellschaft and Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, voicing a preference for KPMG AG Wirtschaftsprüfungsgesellschaft, and stating the reasons. This final report was submitted to the Audit Committee at its November 2019 meeting, which the two final applicants also attended to introduce themselves personally. Based on this comprehensive reporting, the Audit Committee recommended to the Supervisory Board to propose that KPMG AG Wirtschaftsprüfungsgesellschaft be appointed to review, if applicable, any additional financial information required, within the meaning of section 115 (7) of the WpHG, during the 2021 financial year, until the next Annual General Meeting. They will then be appointed as external auditors for the financial and consolidated financial statements 2021 by the 2021 Annual General Meeting. The Supervisory Board has resolved to follow the preferential recommendation made by the Audit Committee.

### **Remuneration Control Committee:**

The Remuneration Control Committee held six meetings during the year under review.

Pursuant to the requirement set out in section 25d (12) of the KWG, which is reflected in the Rules of Procedure of Aareal Bank's Supervisory Board, the Management Board does not attend Remuneration Control Committee meetings which deal with Management Board remuneration. In the 2019 financial year, the Remuneration Control Committee held four meetings without the Management Board, and two with it.

During its six meetings, the Remuneration Control Committee discussed issues concerning the Bank's remuneration systems and all related matters, fulfilling its original assignment. For this purpose, and to the extent considered necessary, external legal and remuneration advisors were retained to provide support. The Committee supported the plenary meeting of the Supervisory Board in monitoring the inclusion of internal control units and of all other material divisions in designing the remuneration systems, and assessed the effects of the remuneration systems on the Bank's risk, capital and liquidity situation. Moreover, the Remuneration Control Committee supported the Supervisory Board with all issues related to the remuneration of the Management Board. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommendations.

At the beginning of the year under review, the Committee dealt with the Management Board's target achievement for the 2018 financial year and with determining the Management Board targets for 2019.

In March 2019, the Committee finalised the assessment of the appropriate structure of the remuneration systems for the Management Board and employees. The results of the penalty review for employees and the Management Board were also presented, as was the review of the overall amount of variable remuneration as to legal permissibility, pursuant, inter alia, to section 7 of the InstitutsVergV.

The Remuneration Control Committee meeting in June 2019 focused on the completed implementation of the comments which the supervisory authorities had made regarding the remuneration system.

At the two September meetings, the Committee concerned itself with adjusting the remuneration systems for employees after the bonus model for all employees had been harmonised, and with the succession process for the Remuneration Officer. In addition, current corporate governance developments were discussed – including implementation of the new German Corporate Governance Code and ARUG II, as well as the corresponding scheduled adjustments to remuneration reporting with the aim of increasing transparency. In September, the Remuneration Control Committee also dealt with the Management Board members' company retirement provisions, recommending to the Supervisory Board to standardise the employment contracts regarding this issue – in agreement with the individual Management Board members (please also refer to Reporting on remuneration for the Management Board > Measures in the 2019 financial year).

In the meeting at the end of the year, the Remuneration Control Committee dealt with the Management Board's preliminary target achievement for 2019 and determined the Management Board targets for 2020.

### **Technology and Innovation Committee:**

The Technology and Innovation Committee convened for four scheduled meetings in the year under review, during which the Committee discussed the implementation and further development of the digitalisation strategy, market trends, technological developments and innovation trends in detail, especially with a view to clients of the Consulting/Services segment. Potential business opportunities

arising from the growing digitalisation of business processes – and how these can be put to use by Aareal Bank Group, and especially for its clients – were explained by the employees of the Bank and respective subsidiaries responsible for the development, among others.

Further key aspects of regular discussions were issues related to the security and flexibility of IT systems provided and used within the Bank, as well as the general realignment of banking systems and related adjustments to the new requirements in the areas of accounting, regulation, and cyber-security. The IT strategy, budget planning and monitoring of important IT projects were also discussed.

The Committee invited external experts to discuss current developments concerning selected topics.

### Attendance of Supervisory Board members at plenary and committee meetings:

Where members of the Supervisory Board were unable to attend a meeting, they announced their absence in advance, giving reasons. Attendance of Supervisory Board members at meetings is shown in the table below.

Member of the Supervisory Board	Participation in plenary meetings	Quota	Participation in committee meetings	Quota	Number of meetings attended / number of meetings (plenary and committee meetings)
Marija Korsch	9 / 9	100%	28 / 28	100%	37 / 37
Prof. Dr Stephan Schüller	9 / 9	100%	14 / 18	85%	23 / 27
Klaus Novatius (as of 1 January 2019)*	9 / 9	100%	12 / 12	100%	21 / 21
Thomas Hawel*	9 / 9	100%	4 / 4	100%	13 / 13
Petra Heinemann-Specht*	9 / 9	100%	6 / 6	100%	15 / 15
Richard Peters	9 / 9	100%	16 / 16	100%	25 / 25
Dr Hans-Werner Rhein	9 / 9	100%	12 / 12	100%	21 / 21
Sylvia Seignette	9 / 9	100%	6 / 6	100%	15 / 15
Elisabeth Stheeman	9 / 9	100%	10 / 10	100%	19 / 19
Hans-Dietrich Voigtländer	9 / 9	100%	16 / 16	100%	25 / 25
Prof. Dr Hermann Wagner	9 / 9	100%	12 / 12	100%	21 / 21
Beate Wollmann*	9 / 9	100%	6 / 6	100%	15 / 15

\* Employee representative

### Financial Statements and Consolidated Financial Statements

The Supervisory Board instructed PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as auditors by the Annual General Meeting 2019, with the audit of the financial statements and the consolidated financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code ("HGB") and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

All members of the Supervisory Board received the audit reports, including all annexes thereto, in good time before the meeting during which the financial statements and the consolidated financial statements were discussed. Having examined the documents provided, the Supervisory Board members formed their own judgement of the audit results. The external auditor representatives attended the meeting of the Supervisory Board, during which the financial statements and consolidated

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financial statements were discussed, and gave a detailed account of the results of their audit. The representatives of PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft were then available to the Supervisory Board to answer further questions, and to provide additional information. All questions were answered to the full satisfaction of the Supervisory Board.

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB, the consolidated financial statements as well as the Group Management Report prepared in accordance with IFRSs, the proposal of the Management Board regarding the appropriation of profit, and the audit reports, were all examined in detail. No objections were raised to the audit results. In its meeting on 24 March 2020, the Supervisory Board approved the results of the audit. The Supervisory Board thus confirmed the financial statements of Aareal Bank AG (in accordance with the HGB), and approved the consolidated financial statements (in accordance with IFRSs). The Supervisory Board examined and discussed with the Management Board its proposal regarding the appropriation of profit. On the basis of this discussion, the Supervisory Board endorsed the proposal for the appropriation of profit submitted by the Management Board.

## **Non-financial Report**

The Audit Committee and the Supervisory Board concerned themselves with sustainability issues and related reporting during their meetings on 21 and 26 March 2019, and on 5 and 12 December 2019.

Moreover, during its meeting on 19 March 2020, the Audit Committee of the Supervisory Board discussed the summarised, separate non-financial report for 2019 and the result of PricewaterhouseCoopers's audit of that report. Representatives of the external auditors attended this Audit Committee meeting and reported on material results of their commercial review in accordance with ISAE 3000 (revised), undertaken to obtain limited assurance for this report. They answered supplementary questions from Committee members. The Audit Committee conducted a plausibility check of the audit results submitted by PricewaterhouseCoopers, and presented its assessment of the non-financial report (and its analysis of PricewaterhouseCoopers's audit results) to the Supervisory Board. The Audit Committee also issued a recommendation to the Supervisory Board to concur with the results of the audit conducted by PricewaterhouseCoopers. The Supervisory Board followed this recommendation; in its meeting on 24 March 2020, it summarised its examination by stating that it had no objections concerning the non-financial report and the results of the audit conducted by PricewaterhouseCoopers.

## **Communication with Shareholders**

In her function as Chairman of the Supervisory Board, Ms Korsch held discussions with shareholder representatives concerning corporate governance at Aareal Bank. Ms Korsch presented the topics within the responsibility of the Supervisory Board, such as the composition of the Management Board and the Supervisory Board, the remuneration systems for Management Board and Supervisory Board members, the role of the Supervisory Board in the strategy development and implementation process as well as its involvement in environmental, social and governance (ESG) matters, the election of the auditor and succession planning.

## **Training and Continuous Professional Development**

The Supervisory Board members made use of the training and continuous professional development measures offered and required for their task at their own account. Aareal Bank AG supported them in an appropriate manner. Introductory programmes, specifically aligned with the needs of the members who had only recently joined the Supervisory Board in the previous year or at the beginning of the year under review, were carried out, and external training courses offered, with the objective of helping the new members to familiarise themselves with their new office.

Aareal Bank's onboarding process for new members of the Company's executive bodies aims to impart deeper knowledge of the business specifics, the strategy, risk management, accounting, and material legal provisions of Aareal Bank. For this purpose, external training and continuous pro-

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essional measures were offered and discussions with the heads of division of the internal control units, of Finance & Controlling, Group Strategy, and with the Management Board members and chairmen of the Supervisory Board committees were held.

Furthermore, continuous professional development measures take place on a regular basis within the course of Supervisory Board meetings. In 2019, this included two Risk Committee meetings with an in-depth analysis of current regulatory developments and a plenary meeting of the Supervisory Board assessing the risks and opportunities of digitalisation (particularly cyber, ICT, and IT risks with a focus on the platform business and the application of cloud services). To this end, the Supervisory Board meeting in September in the premises of Aareon AG was used for this purpose. The range of topics to be discussed was also extended accordingly.

In addition to its regular meetings, the Supervisory Board convened for a separate informational meeting, during which auditors PricewaterhouseCoopers provided detailed information on current changes and deliberations within the regulatory and legal framework, as well as on the potential impact of such trends upon Aareal Bank.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Group's employees for the strong commitment they have shown during the past 2019 financial year. With their enormous continued commitment – and strong motivation – all Group employees have contributed to the Company overcoming all the challenges it faced extremely well, once again making the Company's success possible.

**Frankfurt/Main, March 2020**

**For the Supervisory Board**



**Marija Korsch (Chairman)**

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## Report on Remuneration Transparency

In accordance with section 21 of the German Act to Encourage Transparency of Remuneration Structures (Entgelttransparenzgesetz – "EntgTranspG"), Aareal Bank AG has been required to prepare a report on equal treatment and equal remuneration. For the purpose of ensuring maximum transparency, and in contravention of the provisions of section 22 (1) of the EntgTranspG, the following report covers the financial and calendar years 2016-2019.

### **1. Measures to promote the equal treatment of women and men, and the impact of such measures**

Gender equality has been Aareal Bank AG's declared goal for many years. The Bank attaches great importance to the equal treatment of women and men, whether in the context of filling vacant positions, with regard to professional development within the company, or in terms of remuneration.

Skills and experience are the only relevant criteria when filling vacant positions. Within the scope of staffing procedures, all vacancies below officer level – both managerial and expert functions – are advertised internally so that all employees are given equal opportunities in the application procedure.

All employees are offered a wide array of training measures for developing their skills. The decisive factor is that all employees – both men and women – are able to fulfil their tasks and have the know-how required. No distinction is made between female and male employees when it comes to participating in such training measures. Employees, regardless of their gender, take part in all necessary seminars to the same extent. To support all employees in striking a better work-life balance, the Bank offers all employees a broad range of family-friendly support services. These include, for example, the support of childcare, parent-child workrooms, helping to find service providers for private childcare, childcare during holidays offered by the city of Wiesbaden, and also the option of working remotely or flexible working hours.

### **2. Measures to ensure equal pay for women and men**

The Bank also deliberately tries to ensure that men and women are treated equally in terms of remuneration. The decisive criteria in this context are that they have the same areas of activity with the same scope of responsibility in the respective positions, and also provide the same performance in the sense of achieving the target agreed upon in advance on an annual basis. The determination of the fixed remuneration of female and male employees is based on the collective agreement applicable for the private banking sector for non-exempt employees. For exempt employees, the determination is based on the provisions of a works agreement in relation to fixed remuneration and positions, pursuant to which fixed remuneration ranges are allocated to the individual expert or managerial positions. Similarly, the variable remuneration components are defined on the basis of a corresponding works agreement. Within the scope of their co-determination rights, the employee representative bodies review whether these provisions are complied with for both men and women. The application of these rules thus provides a structure that results in equal remuneration of women and men as well as to a corresponding transparency. In order to have this structure reviewed externally, the Bank participated in a survey conducted by the German Federal Ministry for Family Affairs, Senior Citizens, Women and Youth regarding pay equality in companies (called "Logib-D") which analysed the remuneration structures of banks in Germany. It was identified that Aareal Bank has a very minor adjusted remuneration difference of 2%. No need for action was identified. Therefore, Aareal Bank AG was granted the "Logib-D tested" certificate in December 2013.

### 3. Details on staff numbers, in accordance with section 21 (2) of the EntgTranspG

	Men			Women			Total
	Part-time employees	Full-time employees	Total	Part-time employees	Full-time employees	Total	
Ø 2016	28.00	498.25	526.25	172.60	266.60	439.20	<b>965.45</b>
Ø 2017	32.40	460.40	492.80	164.10	245.10	409.20	<b>902.00</b>
Ø 2018	31.40	445.00	476.40	158.10	239.00	397.10	<b>873.50</b>
Ø 2019	32.80	456.50	489.30	147.30	221.00	368.30	<b>857.60</b>

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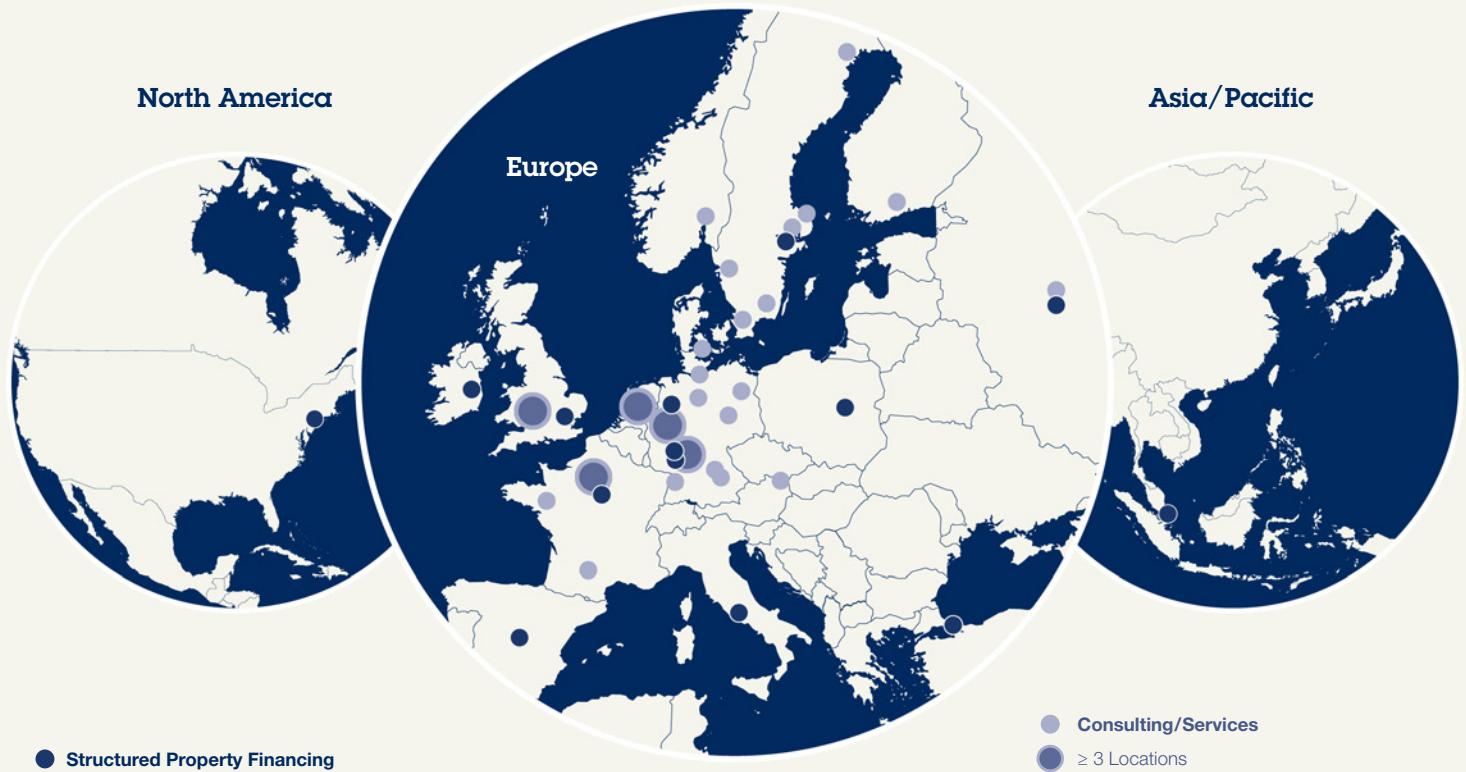
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## Financial Calendar

12 May 2020	Publication of results as at 31 March 2020
27 May 2020	Annual General Meeting – Kurhaus, Wiesbaden
13 August 2020	Publication of results as at 30 June 2020
12 November 2020	Publication of results as at 30 September 2020



**Aareal Bank, Real Estate Structured Finance:** Dublin, Istanbul, London, Madrid, Moscow, New York, Paris, Rome, Singapore, Stockholm, Warsaw, Wiesbaden | **Aareal Estate AG:** Wiesbaden | **Westdeutsche Immobilien Servicing AG:** Mainz, Münster

**Aareal Bank, Group Business Consulting & Services:** Berlin, Essen, Wiesbaden | **Aareon AG:** Amsterdam, Augsburg, Berlin, Bochum, Coventry, Dortmund, Emmen, Enschede, Gorinchem, Grathem, Hamburg, Hattingen, Helsinki, Hückelhoven, Karlskrona, Kiel, Lund, Mainz, Meudon-la-Forêt, Mölndal, Munich, Nantes, Norrtälje, Orléans, Oslo, Paris, Piteå, Southampton, Stockholm, Stuttgart, Swansea, Toulouse, Utrecht, Vienna | **Aareal First Financial Solutions AG:** Mainz | **Deutsche Bau- und Grundstücks-AG:** Berlin, Bonn, Düsseldorf, Frankfurt/Main, Freiburg, Hamburg, Hanover, Leipzig, Moscow, Munich | **plusForta GmbH:** Düsseldorf

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